Making Contracting Work Better and Cost Less

Report of the Contract Reform Team

U.S. Department of Energy Washington, DC 20585

MASTER



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Preface

The Department of Energy is strongly committed to President Clinton and Vice President Gore's efforts to reinvent our government. As the largest civilian contracting agency, the Department must significantly reform its contracting practices to meet this critical commitment.

The unique contracting system that built our nation a nuclear arsenal of unsurpassed power needs a major overhaul to accomplish effectively and efficiently the Department of Energy's changing missions: cleaning up after the Cold War, managing the nation's remaining warheads, strengthening our non-proliferation efforts, and pursuing critical science and energy initiatives.

Experts both within and outside of the Department have identified numerous weaknesses in our contracting practices. Common to all of these weaknesses is a simple, but fundamental, problem: DOE is not adequately in control of its contractors. As a result, the contractors are not sufficiently accountable to the Department, and we are not in a position to ensure prudent expenditure of taxpayer dollars in pursuit of our principal missions. Now is the time to reform our management practices, empower our managers to effect these reforms, and measure their success.

The problems that we identify and the reforms that we propose in this report are not intended to be an indictment of the contractors who work for the Department or the federal managers who direct them. Most federal and contractor employees strive to provide effective service. Instead, it is the overall sys-

tem in which they work that demands our attention. We must create a system that focuses on efficient processes and quality results, rewards initiative and commitment, and provides meaningful disincentives where necessary.

Several key principles guide our thinking about reform:

- We have an obligation to every American taxpayer to spend his or her hard-earned dollars effectively and efficiently. The potential for waste, fraud, and abuse must be in our sights at all times.
- The Department must clearly state what we expect from our contractors and develop meaningful ways to measure whether they are meeting our expectations. We must rapidly inject into our contracting system performance criteria and measurement mechanisms for all of our contractors, including national laboratories, environmental cleanup companies, and support service contractors.
- We need a federal staff with sufficient experience, and in adequate numbers, to manage contracts. We should not be surprised about the depth of the contracting problems we face, with ratios of contractors to DOE employees that exceed 15 to 1 in some programs and a tradition of inattention to best management practices and training.
- We need to develop reward systems that better distinguish between superior and inferior contractor performance and federal

program management. We also need accountability systems that do not leave taxpayers "holding the bag" in cases of contractor misconduct.

• We need to ensure a clear separation between federal workers and contractors so that federal policy development and key program implementation activities are in federal managers' hands. As cooperative as we must be with our contractors, it is ultimately federal officials who must ensure that governmental responsibilities—as established by Congress and funded by taxpayers—are responsibly discharged.

I am pleased to report that we have already taken several meaningful steps that signal our commitment to contract reform. For example, we have frozen contractor salaries for 1994 (resulting in a \$1.55 billion savings over five years), reduced budgeted expenditures for support services by 12 percent in 1994 (expected to result in a savings of nearly \$100 million), and initiated innovative contracting approaches at several sites. As this report reflects, however, we have a long way to go.

I will personally ensure that the report does not sit on a shelf and gather dust. It lays out 47 specific actions we will take to make the Department's contracting process work better and cost less. The report also sets deadlines and assigns primary responsibility for implementation of each action to the Department's program and management officers.

There is, of course, no single right way to correct the problems we have identified. While the actions we propose appear effec-

tive and reasonable today, they need testing in pilot projects and program areas. Moreover, there is no quick fix. True reform will take time.

We readily admit this is a "work in progress." Therefore, prior to putting these recommendations into effect we will seek the input of our stakeholders on the proposed actions, and we stand ready to revise them as appropriate.

I want to thank the many people who contributed to the Department's contract reform effort, including the Contract Reform Team Chairman, Deputy Secretary Bill White; Vice Chairpersons Robert Nordhaus, Cherri Langenfeld, Dan Reicher, and Victor Reis: the members of the Contract Reform Team, including representatives from the Department and the Office of Management and Budget; the Contract Reform Team Staff, including Mary Egger, David Hepner, Linda Johnson, Edward Simpson, Agnes Dover, Pat Godley, Carol Drury, and Kathy Peery and the many other Departmental personnel who supported the team's efforts; representatives of the General Accounting Office; Members of Congress and their staff, including Senators James Exon, John Glenn, Bennett Johnston, and Sam Nunn and Representatives Tom Bevill, Ron Dellums, John Dingell, Philip Sharp, John Spratt, and Mike Synar; and our other stakeholders, including state and local governmental officials, current and prospective contractors, labor unions, nonprofit organizations, and private citizens. I deeply appreciate your experience, insights, and time.

> Hazel R. O'Leary Secretary of Energy

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Introduction

n June 1993, Secretary of Energy Hazel O'Leary formed a Contract Reform Team, chaired by Deputy Secretary Bill White, to evaluate the contracting practices of the Department of Energy and to formulate specific proposals for improving those practices. 1 This report summarizes the results of the work of the Contract Reform Team. It recommends actions for implementation that will significantly improve the Department's contracting practices and will enable the Department to help create a government that—in the words of Vice President Gore—"works better and costs less."2 These actions and the deadlines for their implementation are listed at the end of this introduction. Among other things, they recommend replacing the Department's standard Management and Operating Contract with a new Performance-Based Management Contract and strengthening the Department's systems for selecting and managing contractors.

Contracting at the Department of Energy

- The Department of Energy is engaged principally in four types of activities, each of which draws on substantial expertise in the private sector:
 - Fundamental research in basic sciences.
 - Development of applied science and technologies principally related to increasing efficiency, ensuring future energy supplies, and understanding the effects of energy use on the environment.
 - Development of nuclear defense and nonproliferation technologies and strategies.
 - Environmental restoration and waste management, principally at nuclear weapons production facilities.

To accomplish these and other functions, the

Mission of the U.S. Department of Energy

The Department of Energy is entrusted to contribute to the welfare of the nation by providing the scientific foundation, technology, policy, and institutional leadership necessary to achieve efficiency in energy use, diversity in energy sources, a more productive and competitive economy, improved environmental quality, and a secure national defense.

Department relies extensively on contracts with private-sector organizations and academic institutions. In fact, the Department spent over three-quarters of its Fiscal Year 1993 budget on contracts.

MAJOR DOE CONTRACTING ACTIVITIES

Most of the Department's contract expenditures fund three areas of activities: management and operations, environmental restoration and waste management, and support services.³

Management and Operating Activities

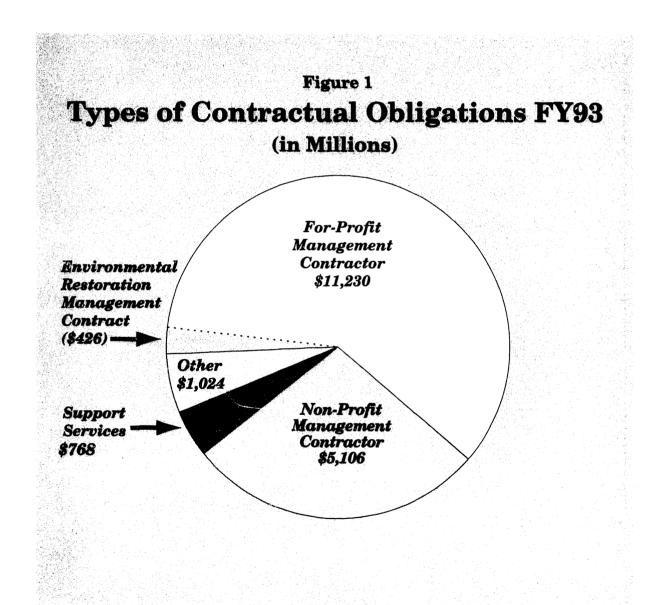
The Department has 52 contracts with various entities to manage and operate its numerous sites, including research and development laboratories and nuclear weapons production facilities. Of these, 34 are performed by for-profit companies, and the balance are performed by nonprofit organizations. These contracts generally are termed "M&O" contracts. As Figure 1 illustrates, DOE spent approximately \$15.9 billion of its \$18.2 billion total Fiscal Year 1993 procurement obligations on M&O contracts. Four of those contractors alone accounted for over \$9 billion in expenditures⁴ (Figure 2).

The Department's contracts for managing and operating DOE facilities originated with the Manhattan Project.⁵ Based upon a need for speed, secrecy, and highly qualified indi-

viduals, the Manhattan Engineer District of the Army Corps of Engineers found it essential to obtain the participation of industry and academia in the risky job of developing nuclear weapons. After World War II, the Atomic Energy Commission and the Energy Research and Development Administration—both Department of Energy predecessors—determined that continued private-sector participation helped to

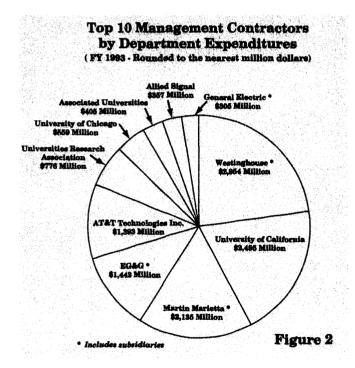
preserve national security, through technological advances in both defense and civilian scientific activities in the Cold War era.⁶

To attract private industry to the high-risk and secretive job of designing and producing nuclear weapons, M&O contracts traditionally relieved contractors of most financial risk and provided for only limited external oversight of contractors' activities.



Moreover, M&O contracts assigned responsibility for all aspects of running a facility to a single prime contractor. Using one integrated contractor at each major facility made administration of contracts more convenient, facilitated the development of the integrated weapons complex necessary to the success of the program, and helped limit disclosure of classified operations. Over the years, some sites acquired more than one M&O contractor for certain functional areas, such as security, engineering, medical, and air transport services.

These traditional M&O contracting practices generally have survived in the post-Cold War era. These practices, however, do not necessarily make sense for facilities



now focused on waste management and environmental restoration instead of weapons production. Companies that have specialized expertise in handling waste and environmental restoration typically are not defense contractors, and environmental work typically is more project-oriented than product-oriented.

Environmental Restoration Activities

In 1992, the Department developed a variation of the traditional M&O contract to perform the environmental restoration activities required by the Department's post-Cold War mission. The Environmental Restoration Management Contract was intended to increase contractor accountability and federal oversight of contractor waste management and cleanup activities. DOE is using this new contract in one pilot program that accounts for approximately \$426 million of the Department's \$18.2 billion total procurement obligations (Figure 1). While the new contract attempts to correct some of the shortcomings of DOE's traditional M&O contracts, it is a cost-reimbursement contract that shares many features of the traditional M&O contract in need of reform.

Support Services

DOE obtains a variety of goods and services through contracts and procedures frequently used by other federal agencies. For example, it uses "support service" contracts for discrete services ranging from routine tasks (such as clerical support and moving services) to highly specialized technical support in various program areas. Support service contracts account for about \$768 million of the Department's \$18.2 billion total contracting costs. Substantial growth in support service contracts has caused an overreliance on contractor expertise to accomplish the mission of the Department. In addition, DOE's use of cost-reimbursement type contracts with

poorly defined work requirements in support service contracts shifts the performance and cost risks to the Department.

COST-REIMBURSEMENT CONTRACTS

The Department historically has relied principally on three types of "cost-reimbursement" contracts:

• Cost-Plus-Award-Fee Contract. This type of contract compensates the contractor for costs that it incurs⁷ in performing the contract, and provides for a fixed-base fee and an additional fee awarded on the basis of the Department's evaluation of

the contractor's performance.

- Cost-Plus-Fixed-Fee Contract. This
 type of contract requires the Department
 to reimburse the contractor's incurred
 costs and to pay a fixed fee specified in
 the contract for contract performance.
- Cost-Plus-No-Fee Contract. This type of contract reimburses the contractor for its incurred costs. DOE pays no additional performance fee. However, in the case of contracts with academic institutions, the Department sometimes pays a management allowance to defray the expense of support by the institution.

The Need for Reform

Department has its strengths and weaknesses. Cost-plus-award-fee contracts theoretically give contractors an incentive—in the form of the award fee—to perform well. Many of the Department's award-fee contracts, however, suffer from the absence of well-defined performance criteria and measures that would allow the Department to effectively evaluate whether and how much to award in fees.

To be effective, these performance measures must encompass:

- Policy-oriented, programmatic objectives.
- Business, management, and other financial objectives, such as financial accounting, cost containment, human resources, public responsiveness, and promotion of small and minority businesses.
- Environment, safety, and health objectives.

Also, the Department's financial management practices in general have failed to produce the information needed to allow senior federal managers to manage effectively. Cross-cutting data have been missing from the financial reporting system. Examples would include information about such items as the relative percentage of overtime spent across facilities, the percentage of basic research dollars spent on costs other than front-line researchers,

the comparative costs expended on security per square foot of secured area, and the comparative cost per square foot of real estate management.

Finally, the effectiveness of the Department's contracting generally has cuffered from the lack of competition for Departmental projects and contracts. This problem has three principal causes. First, DOE has several long-term relationships

The DOE Inspector General has devoted **L** a great deal of time to review of the Department's contracting problems. A series of Inspector General Reports have highlighted the following issues: inadequate federal control over M&O contracts, overly broad indemnification of contractors, inadequate contract administration staffing in DOE field offices, problems with DOE's recently adopted Accountability Rule, use of vague and nonstandard provisions in contracts, weak financial and accounting controls, inadequate DOE review and approval of contractor procurement and property management, and problematic administration of contractor pension benefits.

Testimony of Secretary Hazel R. O'Leary before the House Committee on Energy and Commerce Subcommittee on Oversight and Investigations with particular contractors. When contracts with these contractors expire, DOE's contracting practices tend to favor extending the existing contractor's contract, rather than seeking competitive proposals from other contractors. Second, the government's procedures for obtaining contract proposals and awarding and administering contracts are burdensome, protracted, and costly, thus discouraging some of the most qualified market participants from doing business with the Department. Third, particularly in the programs concerning weapons design and production, waste management, and environ-

mental restoration, some contractors have become increasingly reluctant to risk the adverse publicity associated with these activities.

The weaknesses in DOE's outdated contracting practices are significant and systemic. The correction of these weaknesses requires a thorough examination of the current mission of the Department and evaluation of the kinds of contracts needed to fulfill this mission at the lowest cost commensurate with quality performance.⁹

Reinventing the Department's Contracting Practices

production specific

Reinventing DOE's contracting practices requires a careful balancing of numerous, often countervailing considerations.

- Diverse Mission. DOE's diverse mission requires a wide variety of activities, principally basic research, applied science, weapons design and production, and environmental restoration and waste management. Given such a diverse universe of contracting requirements, the Department cannot adopt a single, formulaic approach to contracting.
- Quality. The importance of DOE's missions requires that the Department attract the best and the brightest individuals, companies, and institutions—both forprofit and nonprofit—to participate in performing DOE's tasks. In nonbureaucratic laboratory environments, scientists working with DOE and its predecessors have made immensely important scientific breakthroughs and have developed technologies significantly enhancing everyday life. These considerations favor providing many DOE contractors with a significant degree of flexibility and independence in determining how to do work, along with clear guidance and oversight concerning what types of work to do. The National Performance Review's plan to "reinvent government" contains some tenets of how to accomplish this mix: "assign responsibilities and measure outputs, del-

- egate authority by empowering employees, and use incentives and penalties rather than mandates."10
- Least Cost. As a responsible government agency, the Department must also ensure that its tasks are performed at the least cost commensurate with quality results. The current fiscal condition of the U.S. government requires all the more sensitivity to costs. This consideration suggests strong incentives for cost savings must exist in the Department's relationships with its partners in the public and private sectors.

After a concentrated review of the Department's contracting practices, the Contract Reform Team proposes a fundamentally different approach to contracting and contract management at DOE intended to balance these policy considerations effectively.

The Contract Reform Team's principal focus has been on DOE's traditional cost-reimbursement M&O contracts. The combination of the team's recommendations results in a new form of management contract—a "Performance-Based Management Contract." This type of contract will be awarded pursuant to the same procurement authorities as the traditional M&O contract, but it uses essentially different contract tools to solve problems inherent in the traditional M&O contract, as illustrated in Table 1.

Table 1
Changing to Performance-Based Management Contracting

Problem	Traditional M&O Contract	New Performance-Based Management Contract Management contractor will not necessarily perform most operations, especially when specific functions can be subcontracted at a lower cost to a specialized contractor.		
Management contractor is not always the best entity to do the work.	Presumes the manager will be the operator.			
Loose accountability for performance. Few quantitative controls to ensure funds are spent on highest priorities.	Broad, subjective statement of work. Department oversees inputs.	Well-defined, objective performance criteria and measures for program activities; environment, health & safety requirements; and financial and management objectives. Periodic updates. Department measures outputs.		
Few cost controls.	Cost reimbursement.	Fixed-price contract (with limited work-change orders) or cost-sharing arrangements preferred.		
Federal employees "check checkers" and manage costs. Inadequate staff.	No meaningful incentives to reduce costs.	Incentives to reduce costs through such measures as sharing costs and cost savings and strictly enforced performance criteria and measures. Fewer federal "checkers" with better skills.		
Fee awards have not properly reflected the quality of performance.	Compensation based on criteria applied in post-performance review process. Relatively little input from Program Offices.	Compensation based on measurable objective criteria established in the contract. Strong programmatic input, with comparisons throughout Department.		
Insufficient fee incentives for excellence; fees tied to scale of operations.	Levels of total contract funding unrelated to contractor performance.	Year-to-year contract funding more dependent on contractor performance. High-performance programs get more discretionary research funds.		
Government reimburses costs that it should not.	Fines and penalties, third-party claims, and similar costs typically allowed.	Fines and penalties and third-party claims unallowable, with well-defined exceptions where prudent business judgement is excercised.		
Insufficient competition for contracts.	Contracts typically extended, rarely completed.	Ordinarily competed at least every 10 years. Procurement process streamlined.		
Strong bias for existing contractors.	Contractor selection heavily emphasizes prior work at the facility.	Stresses selection of contractors recognized as "best in class."		
Insufficient financial accountability.	Financial oversight by review of annual cost vouchers.	Enhanced financial data management system provides meaningful oversight tools, emphsizing comparison to program, Departmental, other agency, and private-sector benchmarks.		

The Contract Reform Team developed the Performance-Based Management Contract after numerous team meetings and studies by individual team members at DOE Headquarters and Field Offices. The Performance-Based Management Contract also reflects input received from numerous members of the public and other federal and state government sectors who have a stake in DOE's contracting process. 11

The Performance-Based Management Contract and other innovative contracting approaches proposed in this report will meet the Department's goals—and the goals articulated in the National Performance Review—of making DOE's contracts work better and cost less, whether the Department is contracting for management and operation of DOE facilities, environmental restoration activities, or support services. However, implementing this approach is only a first step in what will be an ongoing process of continuous improvement and reform.

Other initiatives undertaken by the Department will be necessary to overcome some of the barriers needed for contract reform. Secretary O'Leary has initiated "total quality management" techniques at the Department, emphasizing strategic planning, teamwork, empowerment, and accountabil; y for results. DOE also has begun a process of workforce restructuring to upgrade and change the skill mix of its managers. For example, project management skills and

experience have become much more important as many of the Department's weapons production sites have moved from production to environmental cleanup. Increased emphasis on training in the best-of-class, privatesector financial and management information systems is necessary to monitor contractor performance and will require some shift of skills within the Department. These are examples of the upgrading of skills that is necessary as part of the Department's overall human resource strategic plan. This report will highlight these needs, but it will not substitute its conclusions for those of the strategic planning process on these very issues initiated by Secretary O'Leary.

ACTIONS RECOMMENDED BY THE CONTRACT REFORM TEAM

This report of the Contract Reform Team recommends a series of actions that will reform the Department's contracting practices and contract management techniques. Table 2 lists the specific actions the Department will take to make its contracting practices work better and cost less. It also sets deadlines and specifies "deliverables" for these actions, and identifies who is responsible for carrying them out. Because some of the actions will have far-reaching effects in DOE and among its stakeholders, in implementing the recommendations the Department will consider comments received from DOE personnel and stakeholders during the 30-day period following the publication of this report.

Table 2 ACTIONS RECOMMENDED BY THE CONTRACT REFORM TEAM

Action Review current M&O contracts and identify discrete tasks for fixed- price contracts and sub- contracts.	Deliverable Policy on identification of tasks, requirement for use of other than cost- reimbursement contract, and formal incentives to contractors for increasing percentage of fixed-price contracts.	Deadline June 1, 1994	Responsibility Program Offices
Test the effectiveness of using fixed-price contracts.	Plan outlining periodic audits/reviews.	December 31, 1994	Deputy Assistant Secretary for Procurement and Assistance Management and Operations Offices
Develop programmatic performance criteria and measures.	A matrix of generic and programmatic performance criteria and measures.	March 31, 1994, for generic criteria and measures; June 1, 1994, for 15 largest M&O contracts; and December 31, 1994, for all others.	Program Offices
Develop business management performance criteria and mesures.	A matrix of generic per- formance criteria and measures.	March 31, 1994, for generic criteria and measures; June 1, 1994, for 15 largest M&O contracts; and December 31, 1994, for all others.	Cross-cutting team of representatives from Program Offices, Operations Offices, and Office of Environment, Safety and Health
Develop performance criteria and measures for securing superior envi- ronment, safety, and health performance.	A matrix of generic and specific performance criteria and measures.	March 31, 1994, for generic criteria and measures; June 1, 1994, for 15 largest M&O contracts; and December 31, 1994, for all others.	Cross-cutting team of representatives from Program Offices, Operations Offices, and Office of Environment, Safety and Health
Establish procedures for the development and use of performance criteria and measures.	Guidelines for the implementation of performance criteria and measures in the contracting process.	April 30, 1994	Program Offices, Deputy Assistant Secretary for Procurement and Assistance Management, and Office of the General Counsel
Train DOE program personnel in performance-based contracting.	Plan for training person- nel in performance-based contracting.	May 1, 1994	Assistant Secretary for Human Resources and Administration

Action Create and implement tailored incentives for Performance-Based Management Contracts.	Deliverable For-profit and nonprofit contractor incentive mechanisms.	Deadline July 1, 1994	Responsibility Cross-cutting team of representatives from Program Offices, Operations Offices, and Office of Environment, Safety and Health
Establish an appropriate management fee policy for nonprofits.	Revised fee policy.	October 1, 1994	Associate Deputy Secretary for Field Management, Deputy Assistant Secretary for Procurement and Assistance Management, and Assistant Secretary for Energy Research
Establish compensation incentives for senior non-profit laboratory personnel.	Performance-based incentive compensation policy for senior laboratory personnel.	October 1, 1994	Associate Deputy Secretary for Field Management, Assistant Secretary for Human Resources and Administration, and Assistant Secretary for Energy Research
Develop a DOE-wide incentive program for the contractor cost-reduction/cost-avoidance programs.	Policy guidelines and implementation plan.	September 1, 1994	Associate Deputy Secretary for Field Management, Deputy Assistant Secretary for Procurement and Assistance Management, Office of the Chief Financial Officer, and Operations Offices
Use cost-sharing arrangements in Performance- Based Management Contracts.	Require solicitation of cost-sharing arrangements in the selection process for new contractors.	September 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management and Assistant Secretary for Energy Research
Use multiple-fee arrangements in Performance- Based Management Contracts.	Policy guidelines on the use of multiple-fee arrangements.	September 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management
Develop incentives for environment, safety, and health risk-prevention programs.	Incentive mechanisms for environment, safety, and health risk-prevention programs.	August 1, 1994	Assistant Secretary for Environment, Safety and Health and Associate Deputy Secretary for Field Management

Action Obtain quality performance at the least cost, consistent with Departmentally approved program-specific factors.	Deliverable Policy and program-specific criteria regarding DOE "make-or-buy" decisions.	Deadline August 1, 1994	Responsibility Program Offices
Require management contractors to prepare "make-or-buy" plans.	Contractual requirements and associated incentives for an annual "make-orbuy" plan.	October 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management, Associate Deputy Secretary for Field Management, and Assistant Secretary for Defense Programs
Contract for routine services at the lowest practicable cost.	A plan setting forth criteria for buying landlord services, and a schedule for transition of work. This plan must address workforce displacements.	August 1, 1994	Operations and Field Offices
Except in unusual circumstances, automatically compete management contracts after no more than one extension.	DOE policy emphasizing competition.	August 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management, Assistant Secretary for Environmental Restoration and Waste Management, and Office of Energy Research
Negotiate the terms of the extended contract before making the extend decision, and make the decision-making process open to public scrutiny.	Revised extend/compete policy.	August 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management and Office of the General Counsel
Develop evaluation and selection criteria that increase competition.	Guidelines that will increase competition.	August 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management, Office of the General Counsel, and Operations Offices

Action Create a Procurement System Improvement Task Force to evaluate and streamline the Department's procurement process.	Deliverable Report and recommendations to increase the speed, quality, and competitiveness of DOE procurements.	Deadline December 31, 1994	Responsibility Deputy Assistant Secretary for Procurement and Assistance Management, Office of the General Counsel, and Operations
Identify DOE support services that can be cost- effectively performed by federal employees.	Plan to reduce program costs and improve program management by converting contractor positions to federal positions over the next three years.	August 1, 1994	Offices Program Offices
Reduce support service contracting by at least 10 percent in Fiscal Years 1995-97.	Plans for reducing support service contracting in FY 1995-97.	August 1, 1994	Program Offices and Office of the Chief Financial Officer
Implement performance- based contracting meth- ods for support service contracts.	Plan for conversion to performance-based support service contracts.	June 1, 1994	Program Offices and Operations Offices
Improve DOE's financial management information system.	Revised financial information system.	February 1, 1995	Chief Financial Officer and Program Offices
Ensure that the Office of the Inspector General's audit goals place high priority on reviews and evaluations of contrac- tors' financial manage- ment systems.	Revised audit plans that reflect the new priorities of the Department.	December 31, 1994	Chief Financial Officer
Develop Department- wide guidelines for coor- dination of contractor oversight programs.	Guidelines for coordination of contractor oversight.	December 1, 1994	Associate Deputy Secretary for Field Management, Deputy Assistant Secretary for Procurement and Assistance Management, and Chief Financial Officer
Explore the use of alternatives to the Voucher Accounting for Net E penditures Accrued.	Report and recommendations on alternatives.	December 31, 1994	Chief Financial Officer

Action Evaluate increasing Departmental capability for review and audit of contracts and contractors.	Deliverable Report on evaluation and recommendations for alternatives.	Deadline February 1, 1995	Responsibility Office of the Inspector General, Chief Financial Officer, and Deputy Assistant Secretary for Procurement and Assistance Management
Provide the Defense Contract Audit Agency with the funding needed to eliminate audit back- log.	Report on costs and benefits of obtaining additional resources and recommendations on alternatives.	September 30, 1994	Associate Deputy Secretary for Field Management, Deputy Assistant Secretary for Procurement and Assistance Management, and Chief Financial Officer
Train DOE managers to use integrated financial and managerial reporting systems effectively.	Training program and implementation plan.	December 1, 1994	Assistant Secretary for Human Resources and Administration and Chief Financial Officer
Initiate Department-wide benchmarking of various indirect-cost categories against the "best in class" of public and private businesses, and initiate planning for specific goals for reducing indirect costs.	Report on specific goals and benchmarks and implementation plan.	February 1, 1995	Chief Financial Officer and Assistant Secretary for Environmental Restoration and Waste Management
Establish effective contract performance measures for real and personal property management and accountability.	A matrix of generic and specific performance criteria and measures.	June 1, 1994	Assistant Secretary for Human Resources and Administration
Manage contractors' maintenance costs more effectively.	System to track maintenance costs.	July 1, 1995	Assistant Secretary for Human Resources and Administration and Chief Financial Officer
Develop a Department- wide policy on pension fund management and oversight.	Policy for managing and overseeing pension funds.	July 1, 1994	Assistant Secretary for Human Resources and Ad- ministration, Office of the Chief Financial Officer, and Office of the General Counsel

Action Develop Departmental policy on claims adjustment and evaluation of contractor risk management.	Deliverable Policy for insurance risk management.	Deadline December 1, 1994	Responsibility Assistant Secretary for Human Resources and Administration and Chief Financial Officer
Implement improved overtime policy.	Policy on use of contractor overtime.	April 1, 1994	Associate Secretary for Field Management and Assistant Secretary for Environmental Restoration and Waste Management
Conduct two reviews of uncosted balances each year.	Report on uncosted balances.	July 1 and November 1 annually	Chief Financial Officer
Re-examine the need for advanced funding through special bank accounts.	Report on continued need and alternatives.	October 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management Chief Financial Officer, and Office of the General Counsel
Revise the Department of Energy Acquisition Regulation provisions on fines and penalties, third- party liabilities, and relat- ed matters.	Notice of proposed rulemaking.	September 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management and Office of the General Counsel
Apply comparable reimbursement rules to non-profit contractors.	Notice of proposed rulemaking.	September 1, 1994	Deputy Assistant Secretary for Procurement and Assistance Management and Office of the General Counsel
Develop guidance on determining the "reasonableness" of contractor costs.	Guidelines on "reason-ableness."	January 31, 1995	Office of the Chief Financial Officer, Assistant Secretary for Environmental Restoration and Waste Management, and Assistant Secretary for Defense Programs

Action Develop and implement a contractor indemnification scheme for response action contractors consistent with the principles of section 119 of CERCLA.	Deliverable Notice of proposed rule-making.	Deadline December 1, 1994	Responsibility Office of the General Counsel
Issue uniform guidance on the review and oversight of contractor litigation.	Guidelines on procedures for litigation management.	March 31, 1994	Office of the General Counsel
Institute training in litigation management techniques.	Identification of training programs, and establishment of roundtable discussion format for Chief Counsel meetings.	March 31, 1994	Office of the General Counsel
Select one or two large pilot cases for immediate implementation of litigation cost-reduction techniques.	Report on pilot projects, including recommendations for cost reductions.	July 1, 1994	Office of the General Counsel
Develop an explicit poli- cy concerning the allowa- bility of defense costs in "whistleblower" cases.	Policy on allowablility of defense costs in "whistle-blower" cases.	May 1, 1994	Office of the General Counsel

Making Contracting Work Better

he recommendations of the Contract Reform Team will result in fundamental changes to the Department's contracting practices. Specifically, instead of simply awarding or extending traditional cost-reimbursement contracts, DOE now will:

- Determine whether discrete tasks or functions can be performed and separately competed or subcontracted on a fixed-price basis.
- Develop objective, policy-based performance measures and incentives when a cost-reimbursement type of contract is appropriate for some or all of the work.
- Use the best contracting approach for a specific facility/site that addresses required work, policy-driven requirements, and incentives.
- Actively pursue and solicit competition for new contracts.

This new approach to contracting is outcome-oriented. It requires the development of definitive work scopes and objective performance measurement criteria to replace the ill-defined requirements now contained in most traditional costreimbursement contracts. Once specific performance criteria are established, DOE's contracts must fairly motivate contractors to meet those expectations. To accomplish this, the Department must have a central role in overseeing and evaluating contractor performance and in ensuring that DOE spends taxpayers' dollars prudently.

Accomplishing these changes will require altering the Department's previous system of incentives and reimbursement policies, as well as upgrading its managerial skills. The tasks are formidable and will take time, but the opportunities for substantial benefits demand change.

Selecting Alternatives to Traditional Cost-Reimbursement Contracts

A key objective of the Contract
Reform Team's new contracting
approach is greater reliance on alternatives to traditional cost-reimbursement contracts. These alternatives
include increasing the use of fixed-price contracts and developing and using performance-based management contracting tools.

INCREASING THE USE OF FIXED-PRICE CONTRACTS

There appears to be no compelling reason to use cost-reimbursement contracts for a number of functions now performed by DOE's contractors. The Department could accomplish many routine functions now contracted out by using other types of contracts, such as fixed-price prime contracts and subcontracts in which delivered goods and services are provided at a fixed-price or on a unit-price basis. For example, contracts for specific air transport services and medical services could be priced on a fixed-price basis and obtained under an indefinite-delivery contract.¹² The costs of routine, repetitive services can be estimated with a fair degree of accuracy based on past experience with other contracts or on comparisons in the commercial marketplace.

Moreover, fixed-price contracts place full

performance risk on the contractor. The contractor—not DOE—pays for any inefficiencies that increase the total cost of performance. In addition, fixed-price contracts do not typically entail all of the burdensome administrative oversight activities related to cost-reimbursement contracting, such as special cost accounting system requirements, monthly voucher submissions, indirect-cost management, and final contract audits.



Action: Review current M&O contracts and identify discrete tasks appropriate for fixed-price contracts and subcontracts.

The Department should require DOE program officials to review and identify, on an ongoing basis, specific M&O contracts and specific tasks and services performed by its contractors, the costs of which can be reliably estimated and the work reasonably defined. Goods and services that can be procured on a fixed-price basis should not be contracted for on a cost-reimbursement basis. In addition, in increasing its use of fixed-price contracts, it is essential that the Department ensure that the contracts have specific, well-defined work scopes and outputs. ¹³ Because current, fixed-price contracts often fail to define clearly the work to

be performed by the contractor, performance under fixed-price contracts commonly is characterized by frequent and substantial change orders, resulting in significantly higher actual costs than were originally intended to be "fixed."

The Department also should consider variations on fixed-price contracts, such as unit-price contracts and contracts that have specified incentives and disincentives for failing to meet deadlines and other goals.



Action: Test the effectiveness of using fixed-price contracts.

Periodic reviews to ensure the implementation and effectiveness of this policy change are essential. Lessons learned at the various sites should be shared throughout the Department of Energy. For example, contractors performing similar types of functions at different sites should be benchmarked against one another, and federal managers should compare the relative percentage of fixed-price work between comparable contractors working on comparable problems. The Department should set yearto-year goals for each major facility, stating the minimal amount of work expected from a contractor under a fixed-price contract. Management contractor compensation should take into account the successful use of fixed-priced contracts and other alternatives to cost-reimbursement contracting.

DEVELOPING AND USING PERFORMANCE-BASED MANAGEMENT CONTRACTING TOOLS

Because DOE's traditional contracts for management and operating services account

for the largest part of DOE's contracting budget, the Contract Reform Team concentrated a significant part of its efforts on these contracts. The Contract Reform Team also recognizes that, given the need to maintain and increase partnerships with the private sector, the Department will continue to contract for management services at many of its facilities and laboratories. The Department, like much of the federal government, can benefit significantly from the use of top management expertise from the private sector to execute and implement the programs and policies designed by DOE officials and managers.

The Department will use a new Performance-Based Management Contract when necessary to contract for management and operating services in whole or in part on a cost-reimbursement basis. The key elements of the new Performance-Based Management Contract are listed on the following page.

The Performance-Based Management Contract principally will be a management contract, designed to retain the talents of the private sector in integrating the efficient operation of a site or facility, with no presumption that the contractor will itself handle any or all of the site operations. In this regard, other recommendations in this report—for example, greater use of fixed-price contracting, increased competition, and detailed "make-or-buy" plans—should ensure that the new Performance-Based Management Contract clearly sets out the Department's expectations, rewards superior performance, and minimizes costs to the government.

This section of the report proposes the Performance-Based Management Contract

Key Elements of Performance-Based Management Contracts

- Clearly stated, results-oriented, performance criteria and measures.
- Appropriate incentives for contractors to meet and exceed the performance criteria effectively and efficiently.
- Appropriate criteria and incentives for contractors to seek opportunities to subcontract for tasks that may be effectively and efficiently performed \directly by private firms other than the management contractor.
- Specific incentives for cost savings.
- Improved financial accountability.

as a substitute for the traditional M&O contract. However, the contracting tools recommended for use in DOE's management contracts, in particular the specific performance criteria and measures, are equally valuable for use in all of DOE's contracts.

Performance Criteria and Measures

The development of clearly stated, resultsoriented performance criteria and measures is the cornerstone of the Contract Reform Team's recommendations. These criteria and measures should address three principal areas:

- Performance of the DOE program tasks that are the subject of the contract.
- Performance of business management, financial management, and accounting tasks (including management of human

resources and actions to increase public trust and confidence).

• Performance of environmental, health, and safety tasks.

The criteria and measures should be periodically reviewed, updated, and validated at appropriate levels of the Department.

Appendices F through K provide detailed examples of the types of performance criteria and measures that the Department is developing in each of these areas. Just because they are at the back of this report does not mean they are unimportant. To the contrary, the work of refining the performance criteria and measures—with congressional and stakeholder input—will be critical to the success of the Department's contract reform effort.



Action: Develop programmatic performance criteria and measures.

Each of the Department's four major program areas (Scientific Research, Applied Technology, Defense Programs, and Environmental Restoration and Waste Management) has formulated strategic goals and mission statements as part of the Department's Total Quality Management Initiative. The Department's program offices are translating their strategic goals into specific programmatic goals and objectives that in turn are being reduced to criteria for measuring the performance of DOE programs. Appropriate measures will be specified in contracts in each DOE program area.

The performance criteria and measures

resulting from this effort ought to be applied to DOE programs and operations, as well as to its contractors. The Secretary and Deputy Secretary intend to measure the performance of each of the program areas using similar performance measures. Ultimately, measuring the program areas and the contractors by similar quantifiable criteria should assist the Department and its contractors to align their objectives. This approach could result in a true partnership between the Department and private-sector and academic enterprises, with each having the maximum incentive to accentuate activities that add the most value to their highest, measured priority.

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The following paragraphs summarize performance criteria and measures appropriate for each of the four basic DOE program areas.

• Scientific Research encompasses basic and applied scientific research traditionally done by government or universities. The performance criteria for this program area will address such matters as the quality of the basic science, the relevance of the science to the Department's missions, the construction and operation of research facilities that meet the government's needs, and the effectiveness and efficiency of research program management.

Performance in these areas can be mea-

sured, for example, by using independent peer review groups chosen by the Department. These groups should also be tasked to evaluate scientific programs and to assist the Department in prioritizing them in rank order to reflect the Department's missions. As in the other program areas, the performance criteria should also be based on important policy priorities, such as relevant environmental, health, and safety principles.

The Department of Energy is not the Lonly research organization that is refining its performance measures. American private industry itself has taken great strides in the last 10 years in reorganizing its research and development functions and engaging in strategic planning. In the last decade, the largest American firms doing basic research and development have shifted the decisions concerning how much research and development to buy from company headquarters to operating divisions.

• Applied Technology refers to the many areas of scientific research intended to have near-term commercial applications. The Department's energy, defense, and environmental programs are all engaged in research that may have commercial applications. The types of performance criteria in this area are likely to be similar to those used in a conventional commercial research and development department, such as the value of patent rights, the number of cooperative research agreements, and the ability to attract industrial partners for cost-shared projects.

- Defense Programs include the Department's national security missions, such as maintaining stewardship of the nation's nuclear stockpile. A strategic planning process within the defense programs area has resulted in a restatement of missions that will become the basis for performance criteria. The current defense missions range from effective drawdown and disposition of obsolete facilities to maintaining essential science and technology infrastructure and core competencies. Performance criteria in this area would include, for example, responsiveness to national security requirements and improved program management of drawdown and disposition operations. These criteria could be measured, for example, by improvement in nuclear sensor and search capability, and measured reduction in the costs of disassembling a weapon.
- Environmental Restoration and Waste Management programs include the safe management of waste and the restoration of contaminated sites and facilities. For these tasks, performance criteria will include reducing environmental risks and hazards at Departmental facilities and preventing new environmental damage. As the program matures, more specificity in the nature of the underlying activities will permit the greater use of performance criteria and measures, with accountability at the project level.

DOE's Office of Environmental
Restoration and Waste Management (EM)
recently conducted a performance measurements study of DOE sites engaged in
cleanup and waste management construction projects. The results have prompted
specific Departmental initiatives to improve the productivity of EM's project
management systems to bring them in line

with or to surpass the performance of other federal agencies and the private sector Appendix E highlights the findings and recommendations of the study. Implementation of these recommendations will be an important part of contract reform.¹⁴



Action: Develop business management performance criteria and measures.

In addition to the performance criteria and measures specific to each of the four program areas, the new Performance-Based Management Contract should include criteria and measures encompassing business management activities essential to the contractor's management of the Department's sites and facilities. Included are systems for the effective management of costs, personal and real property, and human resources; innovative management practices; responsiveness to stakeholder concerns; compliance with applicable laws and regulations; and timely implementation of contract commitments. DOE has already established some business management performance criteria to be incorporated into contracts. Appendix J sets forth examples of these criteria.



Action: Develop performance criteria and measures for securing superior environment, safety, and health performance.

The Baldridge Award criteria and the Occupational Safety and Health Administration's Voluntary Protection Program guidelines provide examples of recognized practices that promote the involvement of workers and their representatives in the process of securing a safe work environment. Additionally, the Environmental Protection Agency's Federal Government

Challenge Program seeks from federal agencies agreement to a code of environmental principles that emphasizes pollution prevention, sustainable development, and state-of-the-art environmental programs. The Department should examine these programs in developing environment, safety, and health performance criteria and measures for its contracts.

In addition, the Department's clear commitment to meet labor, community, safety, security, and environmental requirements must be implemented by requiring contractors to develop strategic plans and program/project implementation plans. This requirement must be reflected in the performance criteria developed for DOE's contracts. The Health and Safety Plan required by DOE's present contracting procedures should be modified to provide explicitly for worker involvement and the rights of workers to shut down unsafe operations and to refuse to perform manifestly dangerous work.

Performance criteria also should reflect the need for continued assessments of performance in accordance with a contractor's strategic plan and periodic revisions of the plan to meet changing circumstances. This is especially important in the environmental cleanup area, where surprises are common and environment, safety, and health needs are subject to continual change.



Action: Establish procedures for the development and use of performance criteria and measures.

The Department of Energy must establish procedures (including key organizational roles) for Departmental personnel to:

- Develop contract performance criteria and measures.
- Incorporate performance criteria and measures in contracts.
- Assign near-term and long-term actions for implementing a contract performance measures system (including methods for collecting performance measures results).
- Make these performance standards consistent with those applied to Department program offices by the Secretary and Deputy Secretary in periodic program reviews.

There are significant communication gaps and lack of coordination between the Departmental program offices that select research tasks and priorities, the various Field Operations Offices that manage contractors on a daily basis, and Department Headquarters elements that authorize contracts and make disbursements. In addition, the procurement process itself is too cumbersome. It does not allow program and project managers to shift work from contractor to contractor swiftly based upon such factors as poor performance of the existing contractor or availability of a superior contractor.



Action: Train DOE program personnel in performance-based contracting.

Contracting for performance will require a radical change in the teams assigned to negotiate contracts, select contractors, manage contracts, and determine fees. To implement performance-based contracting effectively, DOE Headquarters and Field program managers need to be trained.

DOE will develop a training program that focuses on performance-based contracting

methods, statement of work preparation, and proper management of contractors.

Additionally, the Department personnel who will be assigned responsibility for evaluating contractor performance must receive appropriate training and technical resources to conduct effective and meaningful evaluations. The training programs will emphasize cost-cutting, appropriate work definition, elimination of excessive contract tasking, maximum efficiency in the use of contractor staff resources, and measurement of contract performance.

Converting to a performance-based management approach to contracting will be a difficult task within DOE, given the need for a reorientation of performance expectations in light of historical biases and resistance to change. Achieving the necessary reforms also will be complicated by an overall federal procurement process that often imposes cumbersome requirements that tend to delay contract actions and increase contractor costs. However, the reforms can and must be implemented successfully over the next few years.

Incentives for Contractor Performance

A critical component of the new Performance-Based Management Contract concept is the design of proper incentives to reward superior performance and discourage substandard performance. The Department should reward cost-effectiveness, superior technical performance, and overall management excellence. Strong incentives need to be fashioned to encourage achievement of the stated performance requirements.

The Department's system of incentives for its contractors must be revised to provide more effective rewards for excellent performance and to compensate the contractors more appropriately for assuming financial risks. Given the unique research-orientation and academic environment of many of DOE's facilities, financial incentives are often not as important to contractors as recognition for scientific achievements and enhanced research funding. DOE's incentive structure, therefore, also must incorporate these nonpecuniary rewards.

Further, given the diverse functions currently performed under most M&O contracts, it may be appropriate for new contracts under the Performance-Based Management approach to include multiple-incentive arrangements.

The Department should reward costeffectiveness, superior technical performance, and overall management excellence.



Action: Create and implement tailored incentives for Performance-Based Management Contracts.

The Department of Energy should consider including the following types of incentives¹⁵ in Performance-Based Management Contracts.

• Cost Incentives. The Department should design a cost-incentive fee approach in which cost baselines are set and contractor compensation is tied to the baselines. ¹⁶
Cost incentives should be particularly useful for project-oriented tasks. Cost-incentive provisions include a target cost, a target profit or fee, and a profit/fee adjustment formula that (within specified limits) provides that contractors receive (1) the target fee if actual costs meet target

costs; (2) a downward adjustment of the target fee if actual costs exceed target costs; and (3) an upward adjustment of the target fee if actual costs are below target osts.

- Technical Performance, Delivery, and Schedule Incentives. Because of the interdependency of cost, technical performance, and delivery goals, a contract that focuses only on one incentive goal may jeopardize achievement of the others. 17 The new Performance-Based Management Contract also should include technical, delivery, and other schedule-related (milestones) performance incentives.
- Future Budget Allocations. DOE should establish an explicit policy of considering a contractor's past performance in determining the contractor's future scope of work and budget allocations under costreimbursement contracts. Contractors with superior performance could receive increased work and budget allocations, and allocations to contractors with inferior performance could be decreased. The Department of Defense has used this policy to promote competition among contractors.

Obviously, the implementation of this recommendation will require careful consideration of a number of concerns—for example, the practicality of the Department's trying to shift tasks between contractors from year to year and the cost of shifting activities from facility to facility. Nevertheless, development of a plan to permit program managers to shift work more easily among contractors and facilities is critical to lowering costs by creating competition among contractors.

• LDRD Allocations. Laboratory Directed Research and Development 18 (LDRD) is

recognized as essential to the future of any research laboratory and is a benefit to the Department of Energy. LDRD allocations in contracts provide flexibility to fund new ideas as they arise. It is a key ingredient to maintaining the health and vitality of a laboratory.

Laboratory directors value LDRD, and it should be used as an incentive to improve overall performance. Each year, the Department should consider the performance of the laboratory in deciding on the appropriate amount of LDRD funding to allow. In addition, in the case of nonprofit laboratories, the Department should consider substituting an additional LDRD allocation for the performance-based management fee.

- Bonus Based on Ranking Relative to Other Contractors. The Department's current method of administering fees does not take into account a contractor's performance relative to other contractors working in comparable program areas. An incentive mechanism based on some kind of cross-cutting ranking could be helpful in: accomplishing goals based more on performance than on the total amount of the contract; encouraging use of more objective criteria that can be understood across program lines instead of substantial reliance on subjective evaluations made by Departmental operations offices; and improving performance through greater competition among existing Departmental contractors.
- Linking Contract Duration and Extension to Performance. The Department should explore and test the feasibility of contractual provisions that reward superior performance with extension of the term of the contract and deter

substandard performance with reduction of the term of the contract. ¹⁹

Action: Establish an appropriate management fee policy for nonprofits.

In fashioning performance incentives, the Department's relationship with universities, research institutes, and other nonprofit organizations requires special focus. Of the 52 current M&O contracts within DOE,²⁰ 18 are with 14 different nonprofit organizations, including 10 academic institutions or consortia of such institutions. All of the 18 nonprofit management contractors operate DOE research and development laboratories. The research ranges from the most basic studies of the ultimate constituents of matter to the discovery and advancement of new, breakthrough technologies. These technologies include those dealing with energy, high-performance computing, global climate change, biotechnology, advanced manufacturing, materials, and the environment. These laboratories often have produced outstanding results, as reflected by the numerous Nobel prizes awarded to their scientists and numbers of Cooperative Research and Development Agreements and licenses.

In developing an appropriate management fee policy for nonprofits, DOE should recognize that a major motivator for most nonprofit contractors is recognition in the scientific and academic communities. For example, effective operation of a national laboratory by a university affects that university's ability to attract the best students and academic researchers and to obtain grants that help build the university's own infrastructure.

Management fees also serve as an incentive. The Department's policy has been not to pay management fees to nonprofit educational institutions.²¹ The Department should change this policy so as to generally permit the payment of a management fee to nonprofits, where they are subject to the same cost-reimbursement rules as for-profit contractors.²² The management fee would vary with the magnitude and complexity of the work under the contracts (as currently is the case for management fees payable to profitmaking firms), and contain a component to compensate the contractor for any increased financial risk. In determining the level of the fee, DOE should consider, among other things, the tax status of the nonprofit organization, so that lesser fees are paid to taxexempt organizations. Additionally, the development of a fee and risk-sharing policy for nonprofit contractors should address the special concerns of nonprofits with respect to protecting university endowments and preserving limited assets.

Finally, if the Department implements the Department-wide performance ranking and future funding and budget allocation incentive policies discussed in this report, they also could be applied to nonprofit contractors. It is important to emphasize that a later section of this report recommends that nonprofits be held to the same controls on cost reimbursement as profit-making institutions. Thus, while nonprofits might now receive management fees for their work, reimbursement of their costs-including fines and penalties—will now be more carefully monitored and controlled than in the past. In this way, the Department will more rationally balance risk and reward in the activities of nonprofits.



Action: Establish compensation incentives for senior nonprofit laboratory personnel.

Establishing financial incentives for senior nonprofit laboratory personnel based on performance measures in the contract will help enforce the Department's performance and cost priorities. For example, a laboratory's performance could be measured against specific performance criteria, and a predetermined multiplier could be applied to calculate the annual salary increase fund for the laboratory's senior managers. This concept, when coupled with an effective performance appraisal system linked to merit pay, can help establish accountability by the laboratories.

"Effective, entrepreneurial governments transform their cultures by decentralizing authority. They empower those who work on the frontlines to make more of their own decisions and solve more of their own problems. They embrace labor-management cooperation, provide training and other tools employees need to be effective, and humanize the workplace. While stripping away layers and empowering front-line employees, they hold organizations accountable for producing results."

Report of the National Performance Review

Special Incentives for Reducing Contract Costs

Often, contractors who manage the Department's facilities and production sites, including their employees at all levels, are in the best position to identify how to streamline and cut costs. However, under the Department's current award fee structure, contractors are not sufficiently motivated to identify cost-reduction or cost-avoidance approaches and apply them to their operations. The award-fee system used under many of the traditional M&O contracts is structured so that a poor rating in one area of measurement can offset positive ratings in all other areas of performance. To overcome this problem, the Department should develop incentive programs outside of the award fee structure to motivate the contractor to reduce or avoid costs without degrading performance.



Action: Develop a DOE-wide incentive program for contractor cost-reduction/cost-avoidance programs.

Currently, three DOE operations offices—Rocky Flats, Savannah River, and Idaho—use cost-reduction/cost-avoidance programs in their contracts. A key component of the programs allows the contractor to share in the savings realized by the Department through the adoption of valid contractor proposals. Although the programs used by the three offices differ, they have resulted in approximately \$150 million in savings during the last two years.

The Department should develop standardized tools to motivate contractors to employ innovative business practices and techniques to reduce or avoid costs associated with contract performance. Similarly, developing ways to share costs with contractors will provide a substantial incentive for contractors to treat government dollars as they would their own and create a market-based incentive for cost reduction. Use of market-based incentives rather than contract man-

dates is a hallmark of the concept of reinventing government, as articulated in the National Performance Review. This type of incentive is discussed in greater detail below. A management contractor's willingness to include such incentives in its contract with the Department should be a material consideration in determining the ranking given a contractor's offer in the competitive selection process.

Contractors should be allowed to share in any hard-dollar savings realized. Each contractor also should be expected to develop a system of cost-saving incentives for its employees. In addition, Department contractors should be evaluated on their ability to substantially reduce middle management and expand the span of supervisory control across all employee ranks, while maintaining superior contract performance. The Department must also develop greater expertise in cost estimation as a managerial control. Reliable cost estimates are an essential element of giving contractors an incentive to cut costs.

In establishing its cost-saving incentives program, the Department should:

- Consider the experiences of existing programs.
- Establish proper baselines and cost measurement tools to ensure that estimated savings are actually achieved.
- Provide training for Departmental personnel responsible for evaluating contractor proposals.

An analogous government-wide program, known as Value Engineering, already exists for Federal Acquisition Regulation contracts, and provides a model that could be considered in developing a DOE-wide approach.²³



Action: Use cost-sharing arrangements in Performance-Based Management Contracts.

There is often a congruence of interests between the Department and a contractor that manages and operates a DOE laboratory or facility. The research and development and other industrial processes conducted at the DOE facilities may offer present and future technical and economic benefits to a contractor beyond the immediate contract. These real technical and monetary benefits argue strongly for the Department and the contractor to share the benefits and results associated with such activities. Therefore, the Department should actively explore joint ventures or other cost-sharing arrangements with contractors.²⁴ These arrangements may be especially suitable in such areas as scientific and applied research and development of technology.



Action: Use multiple-fee arrangements in Performance-Based Management Contracts.

The use of multiple-fee arrangements within a single contract may be more effective than a single-fee structure in creating incentives for superior contractor performance. Under this concept, the most appropriate fee mechanism would be applied to discrete activities and functions performed by a contractor.

For example, a Performance-Based Management Contract for a large, multiprogram site may have fixed-fee, incentive-fee, award-fee, and possibly even fixed-price provisions geared to driving outputs and results. Routine activities, such as cafeteria and housekeeping services, could be subject to a firm, fixed-price or cost-plus-fixed-fee arrangement. In other cases, such as technology development, where the qualitative aspects of technical, schedule, and cost performance are important, the contractor could be subject to an incentive or award fee arrangement.

Special Incentives for Environment, Safety, and Health Performance

DOE's current contracts do not provide incentives to prevent environment, health and safety problems before they occur. Contracts should include incentives that reward a contractor who, for example, successfully implements a pollution prevention activity that eliminates or reduces a waste stream and the attendant waste management costs.



Action: Develop incentives for environment, safety, and health risk-prevention programs.

The Department should include provisions in all contracts to encourage participatory management by workers on environment,

safety, and health, to the extent permitted by law. Likewise, a clause is needed to require that environment, safety, and health implementation plans meet applicable laws and requirements at the least overall cost to the government and to hold the contractor accountable for implementation of the plan.²⁵

Explicit encouragement of preventive actions occurs through a four-pronged effort:

- Link the environment, safety, and health program and budget planning process and management commitment to the contractor's fee.
- Reward contractors for reductions in DOE-targeted risks—for example, meeting the Department's pollution prevention and reduction goals.
- Provide cost-saving incentives to contractors who reduce the costs for environment, safety, and health programs while meeting commitments and demonstrating continuous performance improvement.
- Encourage contractors to establish systems to pass on incentive payments to the responsible employees.

Making Cost-Effective "Make-or-Buy" Decisions

DOE and its management contractors should make more rational decisions concerning whether management contractors "make" or "buy" the services required by a project or program. The requirement to be more cost-effective and to be consistent with long-term strategic objectives for DOE's programs should drive such decisions. In this regard, "make" is defined as those programs, operations, goods, and services that are performed within the Departmental complex directly by the employees of a particular management contractor. "Buy" refers to those that are purchased directly by the Department or by the management contractor responsible for the program or project, including subcontracts and other prime federal contracts.

Numerous opportunities exist to "buy" from commercial sources in the private sector many of the direct program operations, technology programs, infrastructure, landlord, and support activities that are currently performed by employees of management contractors. Increased "buying" of selected services by the Department's management contractors has been occurring throughout the DOE complex (for example, waste treatment, fleet maintenance, laundry services, cafeteria operations, groundskeeping, and computer equipment and services). The Department, however, can make more explicit and cost-effective, make-or-buy decisions. Much can be accomplished through a formal and aggressive

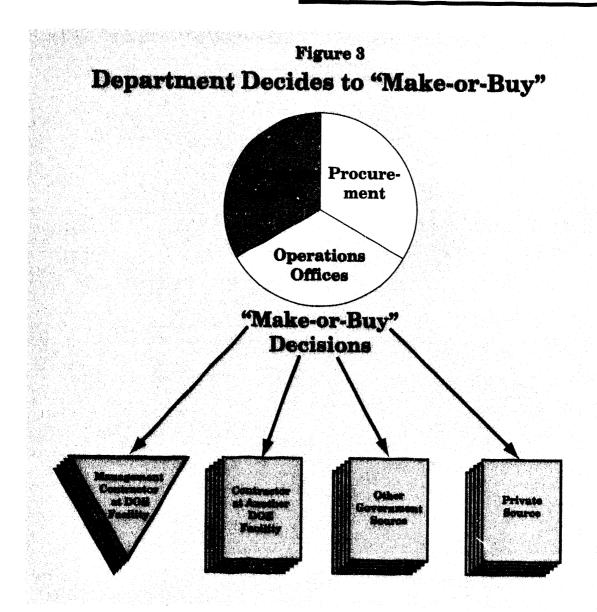
Department-wide make-or-buy effort that will result in enhanced commercialization of technologies and more cost-efficient operations.

There appear to be three principal obstacles to a rationalized process for deciding whether the activities of a particular management contractor should be performed by that contractor.

- Management contractors' fee structures may create distorted incentives for contractors to increase the scale of their operations.
- The delays and costs of the current procurement system slow down the process of bringing in new parties to do part of the work, so that it is easier and quicker to simply expand the activities of a current management contractor.
- The practice of cost reimbursement for overhead items without adequate managerial tools to eliminate layering overhead may cause the government to pay excessive duplicative overhead for subcontractors

Careful planning should allow each of these obstacles to be overcome.

Figure 3 portrays the recommended model for the Department's "make-or-buy" strategy. It schematically depicts the three major organizations within the DOE com-



plex that have significant make-or-buy opportunities. Figure 4 portrays the choices available to DOE's management contractors.

Action: Obtain quality performance at the least cost, consistent with Departmentally approved, program-specific factors.

The Department's make-or-buy decisions should balance least-cost and program-spe-

cific considerations. For example, DOE should establish a general preference for contractors to "buy" various nonprogrammatic "indirect-cost" functions, such as laundry and cafeteria services, unless the management contractor can perform at a lower cost or other overriding "make" reasons are documented. Exercising a preference to "buy" indirect-cost services when they are available at a lower cost represents a significant and important change in DOE contracting practices.

Figure 4 Management Contractor Decides to "Make-or-Buy" Management Contractor at DOE Facility "Make-or-Buy" **Decisions** Integrated Operator

For the Department's applied technology activities that support some strategic goal in the marketplace, such as energy-efficient technologies, the "buy" decision also should be the common path for program deployment. These applied technology programs are unique among the Department's programs in that their primary objectives cannot be achieved without the private sector's taking the lead on issues of commercial applications, market opportunities, and economic requirements.

For placement of "new" work, DOE should survey the marketplace to ensure effective program development, have a solid baseline of the private sector's capability, and determine where the management contractor can best serve the Department's objectives. If the work can best be performed by the existing contractor, then the work should be placed with that contractor. If the capability is generally available within the private sector or another DOE or other government facility, the decision should be to "buy" that work,

unless outside placement of the work is restricted by any other Departmental program factors, such as preservation of a unique technology source, national security, exigency, or maintenance of core-competency support or essential defense capability.²⁶

A transition to a more rational make-or-buy approach to new research and projects cannot happen overnight. Maintenance of certain core competencies within Departmental laboratories is essential to preserve scientific capabilities needed, for example, for defense capability.



Action: Require management contractors to prepare "make-or-buy" plans.

Current Departmental procedures tend to bias contractors to perform various operations themselves. Under the present structure, a contractor must obtain prior DOE approval before it decides to "buy" above certain dollar thresholds. In contrast, where the decision is to perform this work within the contractor's organization, there is no consistent, prior scrutiny by DOE Field or Headquarters personnel.

Detailed "make-or-buy" plans should be prepared that would clearly set forth the areas and actions that each contractor proposes to take in operating the site/facility on a least-cost basis, subject to program-specific guidance on program policy factors that are to be applied to the make-or-buy decision matrix. Once approved, these plans will be incorporated into the contract (and updated as necessary), together with appropriate incentives, and the contractor's performance will be evaluated on meeting or exceeding the agreed-upon expectations.



Action: Contract for routine services at the lowest practicable cost.

Routine services, such as landlord functions, generally should be performed using the least-cost method. In general, these types of routine services should be obtained from the least-cost source consistent with applicable labor laws and regulations and collective bargaining agreements. When the contractor is charged with overall site management responsibilities, the contract should clearly require performance of routine functions by the lowest-cost means available to obtain the agency's requirements.

For work that is currently being performed by a management contractor, DOE must determine whether any restrictions exist (including such factors as sole-source capability, national security, maintenance of core defense capability, and continuity of research effort) that warrant retention of the work with the current performer. Barring any such restrictions, the work should be placed with the organization likely to offer the best value at the least cost.

Finally, DOE must consider the potential for negative impacts on existing contractors' workforces in a transition from a "make" to a "buy" decision, and should structure a plan to minimize any such impacts. Specifically, the Department will ensure that actions resulting in workforce displacements comply with all applicable requirements of Section 3161 of the Defense Authorization Act of 1992.

Increasing Competition to Improve Performance

typically have a term of five years.
For many reasons, including the close working relationships between the Department and its contractors, as well as the complex and time-consuming procurement process, the Department typically has extended these contracts for successive five-year periods. This practice has

resulted in many contractors continuing to perform for decades.²⁸

In determining whether a current contract should be competed or extended, DOE assesses the contractor's performance and considers, among other things, the likelihood that other qualified firms or organizations will compete for the contract (Figure 5) and

Various Providers Have Other Customers

Customers

Private Industry

Universities

Other Government Department
Oppartment
Others

Othe

whether seeking competition would meaningfully improve performance or cost.²⁹ In addition, under the current practice, DOE makes the decision to extend an existing management contract prior to negotiation of the new contract terms. The extend/compete process typically begins about 18 months before the date of contract expiration.

The current process needs revamping. Specifically, establishing a policy in favor of competition versus extension would encourage new bidders to participate, result in continuous improvement in performance, eliminate the prejudice toward incumbency, and preserve the concept of an enduring relationship between the Department and its contractors by allowing for—but not guaranteeing—one contract extension.

In addition, DOE must change the evaluation criteria it uses for selecting its contractors. DOE needs to adopt a strategy for selecting contractors that encourages more companies to compete and attracts the very best management expertise to the Department's laboratories and production facilities. Part of this strategy should consider ways to increase small business and minority contractor participation.

When evaluating the experience and performance of potential management contractors, the Department's practice has been to use criteria that include demonstrated competence and experience in managing and operating programs and facilities similar to certain specialized Departmental laboratories and production facilities (for example, reactor operations, weapons production and testing, and spent fuel processing). This practice may discourage some firms from competing on Department work, and may thereby prevent the Department from tapping the innovation and creativity of the very

best private-sector managers. In addition, these criteria encourage firms responding to the Department's solicitations to propose similar, narrowly focused management approaches, rather than to demonstrate innovation and flexibility. The Department should consider the overall quality of a contractor's performance of nonfederal work in choosing new contractors.

The current process needs revamping. Specifically, establishing a policy in favor of competition versus extension would encourage new bidders to participate, result in continuous improvement in performance, climinate the prejudice toward incumbency, and preserve the concept of an enduring relationship between the Department and its contractors by allowing for—but not guaranteeing—one contract extension.

Action: Except in unusual circumstances, automatically compete management contracts after no more than one extension.

Adopting a new orientation to the extend/compete process that favors competition over extension will eliminate the current bias within DOE toward incumbency. This new policy to permit only one 5-year extension to a contract (that is, having contractor tenures of no more than 10 years before the contract must be competed) benefits DOE in several ways:

New firms would be encouraged to participate in the contracting process because potential competitors understand that an incumbent contractor does not have a perpetual relationship with the Department.

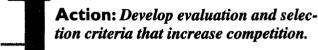
- Contractor performance would improve because a contractor would understand that the quality of its overall performance will be a pivotal consideration not only at the time of the first extend/compete decision, but also in any subsequent competitive procurement.
- DOE's acquisition planning activities will improve because competition will be institutionalized within DOE. Under this policy, the procurement cycle will operate on either a 5- or 10-year cycle.
- By permitting long-term contractual relationships of up to 10 years, DOE can realize the benefits that superior contractor performance provides to the continuity and success of mission-related and scientific programs. In addition, this approach provides industry and academia with assurances that DOE recognizes the complexity of the contractual effort and the magnitude of the resources needed to perform.

In exceptional circumstances, there may be compelling programmatic reasons for extending a contract beyond the 10-year limitation established by this new policy. Such rare cases will necessitate a determination by the Secretary of Energy that no viable alternative sources are available to perform the contract.

Action: Negotiate the terms of the extended contract before making the extend decision, and make the decisionmaking process open to public scrutiny.

Currently, the Department makes a decision to extend a contract before it negotiates the terms of a renewal contract, greatly reducing its leverage during the negotiation process. This practice should end. In addition, the decision-making process to determine

whether to extend or compete a contract should be made more transparent, so that stakeholders have an opportunity to voice their views regarding the contractor's performance.



In the face of changing priorities and funding constraints, DOE needs to encourage participation by contractors with proven managerial experience whether or not they have prior DOE experience. The Department needs to develop new criteria that attract the interest of new entities for managing DOE facilities. When selecting contractors, the Department also should consider entrepreneurial expertise; corporate vision for managerial and technological innovations; capability to increase technology development and transfer; innovation in the cost-effective use of resources; capability to identify, and demonstrated experience in implementing, innovative approaches; environmental, safety, and health expertise; and a proven track record in support of small and minority business goals.

When DOE determines that an existing contract should be extended, the incumbent contractor should be required to submit a proposal addressing these criteria as part of the selection process. Appendix L of this report provides additional examples of the types of factors that should be considered under these evaluation and selection criteria. While implementing the new contracting strategies in this report will help increase competition, 30 additional internal and external barriers will require further examination, analysis, and action. The Department needs to assume a leadership role in generating greater competition.

Streamlining the Procurement Process

One frequently cited inhibitor to competition is the procurement process itself. Common complaints are that the process is too cumbersome, costly, time-consuming, and litigation-prone. For example, a contract for services costing in excess of \$10 million typically takes 16 to 24 months to compete. In extremely large dollar-value procurements, firms can spend in excess of \$1 million in preparing their offers. Even lower-dollar acquisitions can take months. At a stakeholder meeting in New Mexico, one small business executive related his firm's contracting history with DOE and stated that, when it became clear that the firm's proposal preparation costs exceeded his profit margin, he decided not to compete.

"Cutting red tape, organizing services around customers, and creating competition will start to generate an environment that rewards success. Now, we must encourage those within government to change their ways. We must create a culture of public entrepreneurship."

Report of the National Performace Review

DOE's internal processes and procedures needlessly extend the time required to award a contract and provide little or no added value to the quality of the contract. For example, the Department has established dollar thresholds over which contracts awarded by its operations offices must be reviewed and approved before the actual award can be made.

- Action: Create a Procurement System
Improvement Task Force to evaluate and
streamline the Department's procurement
process.

The Department will establish a cross-cutting group to focus on streamlining the Department's procurement process. This group will use a total quality management mapping approach to identify, examine, and recommend revisions of the process. Within DOE, internal processes and procedures exist which needlessly extend the time required to award a contract and provide little or no added value to the quality of the contract. For example, the Department has established dollar thresholds over which contracts awarded by its Operations Offices must be reviewed and approved before the actual award can be made. The Department should review these thresholds and other similar controls to determine their need and value. The task force also will emphasize enhancing the opportunities afforded small and minority businesses, and will recommend legislative changes, when necessary.

Notwithstanding the existence of internally established processes that are candidates for streamlining, the procurement process also is largely a product of external measures over which the Department has little independent control. These measures include certain features of the Competition in Contracting Act, the Federal Acquisition Regulation, and a myriad of other procurement-related statutes and regulations. However, as evidenced by the Report of the Department of Defense Acquisition Law Advisory Panel³¹ and the National Performance Review, actions are underway across government to "reinvent" the way the government conducts its con-

tracting activities. Significant recommendations include creating a new "simplified acquisition threshold" of \$100,000 and enhancing the purchase of commercial products. The Department supports these efforts, and plans to assume a leadership role in pursuing the streamlining goals. A critical role of the DOE task force will be to identify opportunities for DOE to participate in government-wide activities relating to procurement improvement.

Reducing the Use of Contracts for Support Services

In the past 13 years, DOE annual expenditures for support services have increased from \$88 million to \$768 million, as the Department's total budget grew from \$15.4 billion (1980) to \$23 billion (1993). In part, this trend reflects the need to obtain new specialized expertise as the Department's mission has changed. However, this increasing reliance on contractors to accomplish the priorities and mission of the Department has raised a number of concerns, including whether: (1) the use of cost-reimbursement contracts is the most cost-effective way to acquire these services; (2) these contractors are performing inherently governmental functions; and (3) these contracts are wellmanaged.32

DOE awards most contracts for technical and management support services on a cost-reimbursement, fixed-fee basis, under which contractor performance is initiated through the issuance of discrete work assignments. This approach provides flexibility to meet unplanned, but immediate, needs in program areas. However, costs frequently exceed original contract estimates, primarily because of poor definition of program requirements, overly broad statements of work, and the underestimation of contract hours.

Often, well-defined support service contracts

may be the most cost-effective means of procuring expertise. In other cases, the growth of support services used on a routine and long-term basis simply highlights the need to change the mix of skills of DOE federal employees.³³

"Every federal agency needs 'support services'—accounting, property management, payroll processing and legal advice and so on. Currently, most managers have little choice available in-house. But no manager should be confined to an agency monopoly. Nor should agencies provide services in-house unless the services can compete with those of other agencies and private companies."

Report of the National Performance Review

Most of the Department's support service contracts do not provide explicit incentives for quality performance and cost control. The contracts often combine in a single support service contract widely diverse requirements (for example, administrative and technical services, and/or recurring and non-recurring requirements). This practice inhibits development of a performance-based work statement, firm pricing arrangements, and objective performance measurements.



Action: Identify DOE support services that can be cost-effectively performed by federal employees.

The Department's Office of Environmental Restoration and Waste Management will convert 1,600 current contractor employees to federal employees over the next three years. They and other highly skilled employees in the Department will form the nucleus of an Environmental Management Service. This plan not only will enable the program to address growing management concerns but also is expected to result in a net savings of \$188 million. This model should be expanded to other program offices.

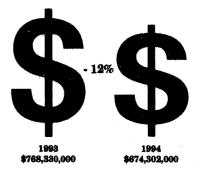


Action: Reduce support service contracting expenditures by at least 10 percent in Fiscal Years 1995–97.

In May 1993, Secretary O'Leary challenged DOE's program offices to make at least a 10 percent decrease in support service contracting in Fiscal Year 1994. The program offices did so, and in fact the reduction will exceed that. The Department will realize a 12 percent reduction in support service dollars in Fiscal Year 1994, by spending \$94 million less on support services than in Fiscal Year 1993 (Figure 6).

The Department will pursue additional reductions in future years by requiring each program office to develop a three-year plan to further reduce its use of support service contractors, as federal skills improve. This process will require program offices to examine the work of their support service contractors and identify contractor services

Figure 6
Changes in Dollars Spent on
Support Service Contracts
from 1993 - 1994



that could be cost-effectively performed by federal employees. Appropriate consideration should be given to the impact that any further reductions would have on small and disadvantaged businesses. The feasibility of substituting federal employees for these functions will depend, of course, on the applicable federal policies that limit federal hiring flexibility, such as full-time-employ-ee-equivalent ceilings and the availability of buyouts and other plans for voluntary retirements.



Action: Implement performance-based contracting methods for support service contracts.

The Department will develop a clear policy calling for the increased use of performance-based contracting methods. It will conduct a survey of current support services to identify types of requirements for conversion to performance-based contracting methods, placing particular emphasis on recurring requirements.

The Department's Savannah River
Operations Office is conducting a pilot
study to develop models for performancebased contracting methods for use in contracts for administrative support services
ranging from clerical support and moving
services to technical support. Information
gained from the study will provide experience and insight in methods of (1) preparing

completion-type statements of work, measurable quality assurance plans, and performance measurement criteria; and (2) developing positive and negative performance incentives. DOE will identify tools to assist in preparing the procurement package and in performing internal reviews of performance-based contracts.

Improving DOE Management and Oversight of Contractors

n addition to improving its contracting practices, the Department must improve its management and oversight of contractors. This effort should focus on (1) strengthening financial and accounting systems; (2) improving the management of various categories of costs, including indirect costs; and (3) modifying and improving DOE's cost-reimbursement policies.

Strengthening Financial and Accounting Systems

The Office of the Chief Financial Officer (Chief Financial Officer) at DOE Headquarters and finance officers at DOE Field Offices are responsible for the Department's oversight of its contractors' financial management systems.³⁴ The Department inherited from its predecessor agencies a financial management process in which the Chief Financial Officer developed and maintained an integrated system of budgeting, accounting, and program cost reporting. With respect to financial information of management contractors, the Department treated contractors as subsidiaries, consolidating and reporting contractors' financial information without generating duplicate accounting records.

DOE also inherited contractor financial oversight procedures dependent on comprehensive field audits. The Department's Office of the Inspector General audits the Department's M&O contracts. The Defense Contract Audit Agency audits the Department's non-M&O contracts, as well as the contracts of the Department's M&O subcontractors. In addition, the Department uses the Voucher Accounting for Net Expenditures Accrued system, which requires contractors annually to prepare and certify that net expenditures accrued were in fact incurred and are allowable under their contracts. This system requires the Department's Inspector General periodically to examine the reliability of the internal controls used by contractors and DOE Field

organizations, to ensure that only allowable costs are claimed and reimbursed.

FINANCIAL INFORMATION SYSTEMS

DOE's current information systems do not provide the kinds of data needed to manage contractors and programs effectively. The financial information gathering and reporting system used by the Chief Financial Officer is designed principally to report the financial condition of the Department, not measure program performance. While the Department gathers much information, relatively little of it can be used on a regular basis by senior managers, for example, to reduce overhead and overtime, or to analyze program accomplishments for dollars spent.

"Management isn't about guessing, it's about knowing. Those in positions of responsibility must have the information they need to make good decisions. Good managers have the right information at their fingertips. Poor managers don't."

Report of the National Performance Review



Action: Improve DOE's financial management information system.

For financial and program managers to be accountable for program results and fiscally responsible for their resources, they must have adequate and accurate accounting information presented in a format that facilitates program analysis and cost control.

DOE program managers need more analytical financial information about contractors' performance. The information also needs to be reported consistently by each contractor program, so that program managers, as well as the Department, can compare contractor performance among sites.

Accordingly, the Department's Chief Financial Officer should meet with DOE program managers and other senior management officials to review and revise DOE's financial management information system, surveying systems currently in the public and private sectors. The revised system should ensure that the information being collected, disseminated, and reported for the benefit of program managers is consistent, useful, objective, timely, and accurate.

CONTRACTOR REVIEWS

DOE can free resources and reduce red tape by moving away from ad hoc reviews of its contractors, and creating real managerial information systems. The disallowance of costs already incurred is an inadequate management tool. Program officials should develop criteria on the reasonableness of costs based on their overall contribution to performance objectives, and contracting officials should scrutinize costs in relation to the value added to achievement of contract goals. Contractors should be expected to develop management systems that ensure that expenditures are reasonable and advance program goals. In addition, governmental reviews of operations offices and management contractors have increased significantly over the years. Many of these activities, however, are duplicative and not efficiently coordinated.³⁵ Meanwhile, the Department's management contractors often are required either by their contracts with the Department or by other non-Departmental institutional or legal requirements to perform internal audits and reviews that duplicate those performed by government officials.

Finally, staffing for contract administration, financial management oversight, and audit activities generally is inadequate in both DOE Headquarters and its Field Offices. The Department's Office of the Inspector General has acknowledged that it does not have the staff or resources to effectively audit the Department's management contracts. In addition, the Department's Field organizations responsible for financial oversight of management contractors are understaffed. The Defense Contract Audit Agency, which audits the Department's non-M&O contracts and its management contractors' subcontracts, also faces a substantial backlog of incurred-cost and close-out audits.



Action: Ensure that the Office of the Inspector General's audit goals place high priority on reviews and evaluations of contractors' financial management systems.

Audits of contractors' allowable costs should focus primarily on the existence and implementation of sound contractor financial management systems, rather than on the multitude of individual contractor costs. In addition, the Department should establish reasonable thresholds below which extensive audit resolution processing is minimized.



Action: Develop Department-wide guidelines for the coordination of contractor oversight programs.

DOE should develop guidelines to coordinate the timing and frequency of contractor oversight reviews. These guidelines should minimize and consolidate elective and discretionary reviews, and eliminate duplicative reviews. Reviews should be effectively coordinated at each Field activity, to minimize the burden on the contractor and interruption of ongoing contractor work.



Action: Explore alternatives to the use of the Voucher Accounting for Net Expenditures Accrued.

The Voucher Accounting for Net Expenditures Accrued (VANEA) serves as the contractor's statement and certification that the net expenditures accrued in fact have been incurred and are allowable under the contract. Approval of a contractor's voucher by the Department's Office of the Inspector General, the head of the appropriate Departmental operations office or delegated procurement official, and the Field Chief Financial Officer constitutes an acknowledgment by the Department that the net costs incurred are allowable under the contract and that they have been recorded in the accounts maintained by the contractor in accordance with DOE accounting policies. Such approval, however, will not relieve the contractor of responsibility for DOE's assets under its care, for appropriate subsequent adjustments for unallowable costs, or for errors that later become known to DOE.

Contractor and Departmental resources used to certify contractors' annual voucher submitted under this audit system may be best

spent on another form of financial report. The voucher itself is an ineffective management tool. However, the Office of the Inspector General's comments accompanying the certifications of the vouchers contain much useful information on the adequacy of a contractor's own internal accounting systems.

DOE should develop a new vehicle to replace this accounting process. The objective should be a comprehensive financial report, similar to the reports that managers in the private sector actually use to manage. Achieving this objective will depend in part on the availability of staffing, since both the Office of the Inspector General and the Chief Financial Officer currently are understaffed to perform their full responsibilities in light of the staffing restraints imposed by federal personnel ceilings.



Action: Evaluate increasing
Departmental capability for review and
audit of contracts and contractors.

The Department's Office of the Inspector General has developed an audit strategy by which it and contractors' internal auditors coordinate the development of audit plans.³⁶ The objective of the strategy is to maximize audit coverage with existing resources and reduce duplicative or redundant audits. The contractors' auditors make their results available to the Office of the Inspector General for review. Based on its evaluation as to whether the contractor's internal auditors have complied with professional standards, the Office of the Inspector General may choose to use the work of the auditors as part of its basis for approving the voucher prepared by each contractor annually.

The Department's Office of the Inspector General and the Office of Management and Budget are cooperating in a review of the Office of the Inspector General's auditing strategy. In this regard, in July 1992 the Senate Subcommittee on Oversight of Government Management issued a report entitled "Inadequate Federal Oversight of Federally Funded Research and Development Centers." This report was critical of the level of federal oversight of these centers, including DOE's administration of 20 research and development centers for which it has responsibility. In its report, the subcommittee raises concerns about the adequacy of the audit function and the audit approach that was in place at that time. The report included numerous recommendations for improving government management of the centers.

In one specific recommendation, the subcommittee report suggested that the Office of Management and Budget complete a study of the audit approach used by DOE. To this end, the Department's Office of the Inspector General provided a briefing to Contract Reform Team representatives, including those from the Office of Management and Budget, regarding the details of its Cooperative Audit Strategy. This presentation clarified a number of issues regarding the propriety and cost-effectiveness of the audit strategy, and the Office of the Inspector General has committed to working further with the Office of Management and Budget and the Senate Subcommittee staff to resolve any outstanding issues that the subcommittee may have.



Action: Provide the Defense Contract Audit Agency with the funding needed to eliminate audit backlog.

DOE should expeditiously identify mechanisms to provide the Defense Contract Audit

Agency with sufficient funding to permit additional resources to be assigned to audits relating to DOE's prime contracts (exclusive of the M&O contracts) and to M&O subcontracts. These mechanisms will serve to eliminate the current backlog in cost-incurred and close-out audits of these contracts and will substantially improve the ability of DOE's managers to administer financial operations. In establishing the incremental level of funding, the Department should prepare an assessment of (1) the extra costs to be incurred by the additional auditing resources, including the indirect costs incurred by contractors through additional audit compliance; and (2) savings generated by the audit.

DEPARTMENT PERSONNEL AND TRAINING

Because DOE's contracting practices historically have not required extensive contractor oversight, DOE lacks sufficient and adequately trained personnel in such areas as contract administration, cost estimation, and financial management.

Accordingly, under the leadership of Secretary O'Leary, the Department is in the process of expanding, training, and retraining its personnel. For example, DOE will expand its federal employment by over 1,000 new federal employees with improved basic skills needed to reduce costs and manage the Department's programs. This employment would be offset by a reduction of employment by contractors by at least the number of new federal employees. These employees will be part of an Environmental Management Service created within the Department. This service should be capable of establishing the spirit of cooperation and pride of accomplishment that has won recognition from time to time for such groups as the National Park Service staff and the staff of the Securities and Exchange Commission. Improved financial and managerial information systems and controls, however, are not simply a matter of more personnel. Many talented personnel already within the Department have had their efforts misdirected. For example, personnel in the Office of the Chief Financial Officer must gather data for different program offices in different forms. These personnel also generate many reports on an ad hoc basis, which requires significant additional effort in the collection of more original data. Creating a computerized, comprehensive data base would allow the Chief Financial Officer to generate reports in different formats from an existing comprehensive data base and

would free a substantial number of employees to address other priority needs



Action: Train DOE managers to use integrated financial and managerial reporting systems effectively.

Training Departmental managers to use an enhanced data collection system and comprehensive and flexible computerized data base system is an additional critical element in strengthening DOE's financial management systems. The Department will create a training program in a timely and effective manner to enable DOE employees to implement the enhanced financial information system.

Improving the Management of Particular Categories of Costs and Cost Controls

In addition to examining and improving its cost-reimbursement policies, DOE should improve the application of these policies with respect to specific categories of costs and cost controls.

INDIRECT COSTS

Certain costs associated with overall operation of a management contractor-operated DOE site are shared among the different Departmental programs operating at that site. These costs, while important to the overall success of the site operation and mission, are not related to specific core program objectives. They more closely resemble "General and Administrative" costs in the accounts of private corporations. As such, these costs are "indirect" to Departmental programs. Examples of such costs are security services, real estate and personal property management and maintenance. materials storage, and administration.³⁷ The Department incurred approximately \$3.7 billion dollars in indirect costs in Fiscal Year 1993. Figure 7 shows the various categories of indirect costs and their respective percentages of the Department's total Fiscal Year 1993 indirect costs.

The management of contractor indirect costs requires the participation of a variety of DOE personnel. For example, Department

Figure 7 **Indirect Costs** (Percentage of Total FY93 Indirect Costs) Safety & Health - Institutional 11.5% Maintenance 9.6% Safeguards & Security 8.7% Information Services 8.4% Management/Allowance Fee 7.6% Facilities Management/Engineering 7.4% Human Resources 5.4% Utilities 5% Chief Financial Officer 4.8% Logistics Support 4.5% Environment - Institutional 4.4% Administrative Support 4% Other 3.7% Information/Outreach Activities 3.1% Executive Direction 2.9% Quality Assurance 2.8% Taxes 2.3% Procurement 1.5% Laboratory Directed R&D 1.3% Legal 1.1%

Headquarters and Field Office financial managers have primary responsibility for defining, allocating, and reporting indirect costs. Program and project managers are responsible for determining the need for, and managing activities that generate, indirect costs. Recent DOE reviews of indirect cost control, however, suggest that program and project managers do not include indirect cost control as a major management objective.

In this connection, on-site reviews of the management of indirect costs at Rocky Flats Field Office, Los Alamos National Laboratory, Oak Ridge National Laboratory, and Oak Ridge Operations/Y12 and analyses of responses to questionnaires from 23 other Field sites indicate that:

- DOE program managers are not adequately evaluating actual indirect cost requirements and effective options for satisfying those requirements.
- Many DOE program managers take the previous year's budget as a base, add escalation, then adjust costs to fit budget targets provided by Department Headquarters. Examining existing scope is sometimes included, but analysis of minimum sizing is seldom accomplished.
- Management control systems are in varying stages of development and implementation across the Department.

PASSING MATERIAL PROPERTY AND ADMINISTRATION OF THE PASSING PA

Action: Initiate Department-wide benchmarking of various indirect-cost categories against the best in class of public and private businesses, and initiate planning for specific goals for reducing indirect costs.

The process for managing indirect costs should:

- Establish the policy that management and cost avoidance and/or savings of indirect costs should be the responsibility of DOE program/project managers as well as the financial managers.
- Give individual employees incentives to reduce indirect costs.

- Devise accounting systems as appropriate to compare the percentage of total costs attributable to indirect costs at various facilities and on various projects and programs to benchmarks inside and outside the federal government. In some cases, peculiarities of federal programs do not justify categories of indirect costs as a percentage of gross expenditures, or payroll costs that differ much from those encountered in the private sector. For example, benchmarks should be comparable between federal facilities and many private enterprises for cafeteria services, parking, routine security services, accounting services, payroll services, and the like. Benchmarks for other functions that have no parallel in the private sector might be best found at other governmental facilties. An example would be security for the nuclear weapons stockpile.
- Set goals during 1994, both by facility and by program, concerning the reduction in the percentages accounted for by various categories of indirect costs. Indirect costs should decrease as levels of supervision decrease and the scope of responsibility of individual supervisors increases.
- Revise current DOE Orders to emphasize the need for control of indirect costs.³⁸

Environment, safety, and health costs have grown significantly. An aggressive implementation of improvements in environment, safety, and health activities is a high priority of the Department of Energy. Control of indirect costs could be used as an excuse to de-emphasize the accomplishment of environment, safety, and health goals. In some cases, the Department may need to continue to increase its expenditure of resources for environment, safety, and health.

As with other categories of indirect costs, environment, safety, health expenditures can be benchmarked against organizations that are the best in their class, or the facility most comparable to the Departmental facility being benchmarked. Benchmarking might allow better allocation of funds among contractors for the purpose of environment, safety, and health protection.

PROPERTY MANAGEMENT COSTS

In Fiscal Year 1992, personal property owned by the Department of Energy had a book value of approximately \$13 billion. The Department generated \$345 million in excess personal property and disposed of \$355 million in surplus personal property through donations, sales, transfers, and other methods. Additionally, DOE owns approximately 10,000 buildings and 15,000 miscellaneous structures at 52 major sites in 120 locations across 45 states. In 1992, DOE allocated approximately \$1.5 billion for preventive and corrective maintenance on its buildings, equipment, roads and grounds, and other property.

Contractors do not always properly manage, control, or account for DOE-owned property. Moreover, DOE lacks a consistent, thoroughly defined oversight program, and uses few, if any, established property management performance measures in its contracts.

Further, the Department does not have a system for tracking, monitoring, and reporting facilities management activities and accumulating costs associated with the maintenance of facilities. Since there is no standardized program for management contractors to report their maintenance costs, DOE cannot benchmark its performance against real property managers in other government agencies and the private sector.

Without this kind of benchmarking, it has been difficult to establish contractual performance requirements essential to identifying, verifying, and controlling costs of maintenance activities.

These deficiencies may result in government-owned personal property being lost, misplaced, or stolen.⁴⁰



Action: Establish effective contract performance measures for real and personal property management and accountability.

Effective contract performance measures for property management and accountability serve to decrease costs and increase inventory accuracy. DOE's Personal Property Management Systems Appraisal Guide (January 1992) identifies measurable criteria for all property management functions.⁴¹ The Department should adjust these criteria and establish quantitative goals by benchmarking property management functions of the Department and its contractors against property managers within the private sector as well as other government agencies.⁴² The criteria need to be reviewed and periodically updated. When established, these additional measures will enhance the Department's ability to monitor contractor performance and to identify areas where improvements are needed.



Action: Manage contractors' maintenance costs more effectively.

DOE will establish a system for tracking, monitoring, and reporting the accumulation of costs associated with real property and facilities maintenance. This system will improve contractor accountability and the Department's ability to develop maintenance budgets. As part of performance-based contracting, all management contractors should accurately accumulate, track, and monitor facility maintenance costs in a fashion that can be used to compare property management costs per square foot for various contractors throughout the Department. These reports should allow costs per square foot to be compared for facilities of comparable vintage and function. DOE should use information obtained through Department and contractor data systems to develop performance measures for maintenance costs.

CONTRACTOR PENSION AND INSURANCE COSTS

DOE's management of contractor human resource programs includes responsibility for oversight of reimbursable management contractor actions relating to 80 defined benefit and defined contribution plans covering approximately 140,000 contractor personnel nationwide. Pension fund actions are highly complex and involve funding, plan amendments, segment restructuring, contract amendments, spinoffs and mergers, pension plan and contract terminations, and temporary investments. Pension plan assets dedicated to contractor employees currently amount to approximately \$13 billion. The lack of qualified personnel has hampered DOE's ability to manage contractor pension costs.



Action: Develop a Department-wide policy on pension fund management and oversight.

The Department should have an explicit policy on its management of pension fund obligations. It should include guidance on funding, benefit levels, employee transfers,

and treatment of incumbent employees when a change in contractor occurs. Additionally, DOE should assess the need for additional resources for pension fund oversight. The Department should assess the proper mix of new or retrained federal employees and outside experts needed to do the most cost-effective pension oversight.

The Department already has begun taking certain actions to reform its administration of contractor pension funds. It is analyzing its options to try to obtain the financial advantages of excess funding of pension assets paid for by government funds. It has also instituted a policy that will be effective in Fiscal Year 1995, if not before, for recognizing the present value of enhancement in pension fund benefits made as part of its workforce restructuring.



Action: Develop Departmental policy on claims adjustment and evaluation of contractor risk management.

Critical components of a Department-wide program for insurance management should include the award of a Department-wide claims servicing contract, the development of a risk management information system, and appropriate revisions to DOE Order 3890.1, "Contractor Insurance and Other Health Benefits Programs." Such a program should also improve DOE's risk management process. Areas of risk management needing improvement include a lack of comprehensive risk management policy, poorly understood coverages under comprehensive general liability policies, unrecognized and unfunded liabilities, and a lack of relevant risk management experience in Operations Offices.

This program would improve: (1) DOE's safety and health activities, (2) communication and information exchange between and among DOE and contractor personnel responsible for the program, (3) operational efficiency through uniformity and consistency, and (4) the performance of DOE personnel in risk management through better training and timely information.

OVERTIME COSTS

The Department of Energy does not adequately supervise contractor overtime costs. Often overtime can save money, compared to not doing the job at all or hiring new permanent workers. However, overtime can also be abused. For example, in Fiscal Year 1992, 9 percent of the contractor workforce earned greater than 40 percent of its earnings from overtime compensation. In Fiscal Year 1993, that percentage dropped to 7 percent. Further reductions should be obtained through improved work definition and better management of personnel.



Action: Implement improved overtime policy.

Existing controls will be expanded to ensure the most appropriate and judicious use of contractor overtime. Among the types of controls that will be considered are:

- Establishing a percentage threshold by site, by labor category, and by individual, where appropriate, for acceptable overtime usage.
- Creating a process by which contractor overtime usage above the guidelines will be specifically approved by the Field Operations Office Manager.

Assigning to each site an appropriate target for reducing contractor use of overtime. By March 1, 1994, the Associate
Deputy Secretary for Field Management will report to the Deputy Secretary concerning the development of policy to controlover-time, and the procedures that have been implemented to enforce the policy.

UNCOSTED BALANCES

The Department had uncosted balances of over \$10.4 billion at the end of Fiscal Year 1993. "Uncosted balances" are funds that the Department obligates to a management contractor for which the contractor has not yet incurred actual costs. The Department obligates funds to its contract work based on an annual program plan. However, the Department's planning and budgeting process has outpaced the contractors' abilities to accomplish the work.

DOE should review uncosted balances twice each year to allow senior management of the Department to determine the reasons for the delay in project funding. Moreover, to the extent that cost savings may be realized by improved program management, those amounts should not simply be lost under the heading of "uncosted balances."



Action: Conduct two reviews of uncosted balances each year.

It would not be true reform simply to eliminate DOE's practice of maintaining uncosted balances, creating incentives for contractors to spend the funds more rapidly than necessary simply to retain funding for capital projects. Automatic reprogramming of uncosted balances could be counterproductive.

Accordingly, beginning in Fiscal Year 1994, the Chief Financial Officer should prepare a report by July 1 and November 1 each year concerning uncosted balances, and DOE's Deputy Secretary or Under Secretary should meet with the relevant Assistant Secretaries of each major program with significant uncosted balances to determine whether and to what extent any uncosted balances should be reprogrammed or identified for use in offsetting future budget requirements. The Chief Financial Officer will continue to prepare the annual report to Congress on uncosted balances mandated by the Energy Policy Act of 1992.

THE ADVANCE-FUNDING MECHANISM

Under the special bank account system, DOE provides advance payment under a letter-of-credit arrangement and special bank account. Through this advance payment mechanism, contractors do not have to finance the costs of operations. As a result, DOE avoids having to compensate contractors for such costs through higher fees. In addition, both DOE and the contractor are freed from the administrative burden of monthly payment processing.

A significant disadvantage of this advancefunding mechanism, however, is that DOE depends on the contractor to identify and remove unallowable costs from its accounts. Additionally, to the extent that costs are disputed, DOE's ability to withhold funds is limited. Thus, DOE has experienced difficulty in recouping questioned costs when the contractor refuses to reimburse DOE.



Action: Re-examine the need for advanced funding through special bank accounts.

The Department must review its practice of funding its M&O contracts in advance through the use of special bank accounts and letters of credit. DOE's Chief Financial Officer and Assistant Secretary for Human Resources and Administration should undertake a cost-benefit analysis of the use of the special bank accounts and the feasibility of eliminating this practice. To the extent that elimination of the practice is uneconomic or infeasible, DOE should revise its cost-reimbursement contracts to provide an effective mechanism to require contractors to reimburse DOE for any disputed cost item.

Modifying and Improving Cost-Reimbursement Policies

DOE's contracting policy must focus on payment for results and not simply payment for incurred costs. This discussion provides an overview of DOE's traditional rules and policies for reimbursing costs under cost-reimbursement contracts, and describes the need to reform those policies.

DOE's contracting policy must focus on payment for results and not simply payment for incurred costs.

Historically, the Department's policy has been to reimburse its management contractors for virtually all costs incurred in the performance of their contracts, including fines and penalties, third-party liability claims, and damage to government property. The only costs not paid by the Department were those resulting from willful misconduct or lack of good faith by the contractor's top-level management personnel; costs found not to be reasonable, based on, among other factors, the exercise of prudent business judgment; and costs specified in the contract as unallowable. Rarely have costs been disallowed.⁴³

APPLYING THE ACCOUNTABILITY RULE

Beginning in the 1980s, the Department came under increasing criticism for the man-

agement of its weapons production and research facilities. The Department's policy of reimbursing almost all of its contractors' costs (which insulated contractors from the economic consequences of their actions) and its inadequate oversight of contractor performance have been viewed as major contributors to the serious environmental, safety, and health problems facing these facilities.

Early in 1991, partly in response to criticism of its contracting policies, the Department modified its cost-reimbursement policies by requiring that the profit-making contractors assume certain risks of contract performance. This new requirement, called the "Accountability Rule," makes the contractor liable for certain costs, known as "avoidable costs," which result from the negligence of the contractor's or subcontractor's employees. However, it contains a number of qualifications that undercut its effectiveness:

- If DOE is responsible in any way for the incident that resulted in the additional cost, then no avoidable cost results and the cost is reimbursable.
- In making an avoidable-cost determination, DOE must consider a number of different—and, in some cases, inconsistent guidelines that are overly complicated and impractical and burdensome to administer.
- The rule imposes a ceiling on the liability of a contractor for avoidable costs.

 The rule does not apply to nonprofit contractors.

In application, the Accountability Rule appears to have had little measurable impact on contractor accountability or performance. At the same time, it has resulted in a significant cost increase to the Department, A review of one year of contract performance under the Accountability Rule disclosed that administrative costs of implementing the rule were estimated to be \$2.5 million for both DOE and the five contractors reviewed.⁴⁴ In addition, the contractors earned an additional \$22.8 million in fees as compensation for the increased risk they presumably assumed under the new provisions.⁴⁵ During the same year, costs determined to be "avoidable" totalled just under \$1 million, and the contractors' performance ratings evidenced no appreciable improvement. It is possible that the deterrent effect of the Accountability Rule discouraged contractors from incurring avoidable costs, but there is little evidence to support a conclusion that the rule has been worth its administrative cost.

In order to increase contractor accountability and create a more equitable and rational allocation of the costs and risks of contract performance between the Department and contractors under the new performancebased management approach, a number of changes need to be made to DOE contracting policies concerning reimbursement of fines and penalties, third-party liabilities and costs resulting from damage or loss to government property. Because many of the actions will apply to nonprofit contractors as well as profit-making firms, thereby imposing greater risks on nonprofit contractors than they incur under current DOE policy, the Department will reconsider its policy against paying management or award fees to educational institutions.46

COMPARING ACQUISITION POLICIES

The Department has a complete set of cost provisions for M&O contracts that are incorporated in the Department of Energy Acquisition Regulation (DEAR).⁴⁷ A detailed comparison of the DEAR to the Federal Acquisition Regulation indicates that, while they appear to differ extensively, the differences, in most cases, are not substantive. Other than certain discrete cost items, such as fines and penalties, there are few, if any, specific costs that are allowable under the Department's regulations but unallowable under the Federal Acquisition Regulation.

In the case of costs such as fines and penalties, the arguments advanced for less stringent treatment of DOE's management contractors (for example, DOE ownership and control of the site) are outweighed by the strong public interest in and concern for compliance with environmental laws and regulations. With respect to other cost principles, the Federal Acquisition Regulation usually provides considerably more detailed and specific guidance for allowability/unallowability determinations than the Department's regulations.

For example, the Federal Acquisition Regulation provides extensive direction on contractor accountability and responsibility for government property, while the Department's direction on M&O contracts in this area is brief and general. When a contracting officer questions a particular contractor activity or incurred cost, the generality of the DEAR has provided DOE management contractors a basis for arguing that the cost is allowable.

The first step in dealing with these problems will be to overhaul the current reimburse-

ment rules in the DEAR regarding avoidable costs. In the longer term, the Department should consider revising its procurement regulations to apply to performance-based management contractors the same cost principles and provisions that apply to other government contractors. Eventual adoption of the cost principles contained in the Federal Acquisition Regulation will send a signal to DOE contractors that the Department intends a businesslike contractual relationship based on clearly articulated standards and criteria for the reimbursement of costs. Because these principles are used throughout the government, their adoption will add a significant measure of uniformity and consistency to the Department's contracting for the management and operation of its facilities and sites. DOE's contractors, in effect, will be subject to the same rules as other government contractors.



Action: Revise the Department of Energy Acquisition Regulation provisions on fines and penalties, third-party liabilities, and related matters.

Because of its traditional practice of reimbursing virtually all costs incurred by M&O contractors, the Department has, in effect, assumed most risks of contract performance. For example, because the Department ordinarily reimburses the contractor for civil fines and penalties incurred in contract performance, contractors have less incentive to comply with applicable laws and regulations than they would if such fines and penalties were disallowed. Similarly, the government's assumption of the economic costs of third-party liabilities probably reduced contractor incentives to minimize these liabilities. The Accountability Rule attempted to address this problem by shifting certain risks of performance (i.e., for avoidable costs) to the contractor.

Instead of using the Accountability Rule, the Department should amend the DEAR to eliminate its avoidable-cost provisions, to develop substantive standards similar to those in the Federal Acquisition Regulation, and to establish a rebuttable presumption of unallowability for fines and penalties, third-party liability, and damage to or loss of government property. The amendment to the DEAR would make these costs unallowable unless the contractor is able to make certain affirmative showings:

- Fines and Penalties. 48 Fines and penalties would be unallowable unless the contractor shows to the satisfaction of the contracting officer that: (1) they were incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer; (2) they were incurred by reason of conditions of the site that were in existence prior to the contractor's first contract at the site after 1993, and that the contractor had no opportunity to remedy; or (3) they were imposed without regard to whether the contractor was at fault or exercised due care, and could not have been avoided by the exercise of due care by the contractor or its employees.
- Third-Party Liabilities. Third-party liabilities would not be allowable unless the contractor shows to the satisfaction of the contracting officer that they did not result from: (1) willful misconduct or lack of good faith by the contractor's managerial personnel; or (2) failure to exercise prudent business judgment. Punitive damages would not ordinarily be allowable under this standard.

 Loss of or Damage to Government Property. Same standard as for thirdparty liabilities.

The current Accountability Rule cap should be removed. Indemnification for damage resulting from nuclear activities carried out by DOE contractors would continue to be provided, as required by the Price-Anderson Amendments Act of 1988, 42 U.S.C. 2210(d). Furthermore, the Department would not reimburse any portion of insurance premiums to cover such unallowable costs. The above rules would apply to non-profit contractors, unless criteria articulated in accordance with the next action in this report indicate that separate treatment is required.

These changes are intended to simplify contract administration and enhance contractor accountability. As in the Federal Acquisition Regulation, fines and penalties are allowable if incurred because of specific contract terms or instructions of the contracting officer. However, in recognition of the environmental conditions that a DOE contractor is likely to inherit when taking over a facility, an exclusion is also provided for certain pre-existing conditions. In addition, in some cases, fines and penalties assessed under strict liability statutes would continue to be allowable.

With respect to third-party liabilities and damage to government property, the disallowance rules reflect generally applicable Federal Acquisition Regulation standards relating to willful misconduct, lack of good faith, and reasonableness of costs (i.e., failure to exercise prudent business judgment).

The above changes in the Department's costreimbursement policies would apply to nonprofit contractors, unless a specific determination were made at the time the contract is negotiated that (1) there is a programmatic need for nonprofit contractors to compete for the contract and (2) a particular reimbursement rule would make it unlikely that such nonprofit contractors would compete.

With respect to third-party liabilities and damage to government property, the proposal to subject nonprofit contractors to the new rules applicable to for-profit contractors would not substantially change the standard of unallowability currently applicable to non-profit contractors (i.e., willful misconduct, lack of good faith, or reasonableness). However, it would revise the process for making allowability determinations by establishing a rebuttable presumption of unallowability.

With respect to fines and penalties, the proposed change differs significantly from the current DEAR by holding nonprofit contractors responsible for fines and penalties unless one of the exclusions applies. However, the proposed change is less restrictive than the current Office of Management and Budget Circular governing nonprofit educational institutions (OMB Circular A-21), because it does not disallow fines and penalties resulting from pre-existing conditions or from the imposition of strict liability.



Action: Develop guidance on determining the "reasonableness" of contractor costs.



Action: Apply comparable reimbursement rules to nonprofit contractors.

Even though a particular cost may be identified as allowable under the cost principles, it still must be "reasonable" to be reimbursed.

"Reasonableness" deals with the standard of care the contractor must observe in incurring reimbursable costs. Generally, a cost is reasonable if it would be incurred by a prudent person in conducting a competitive business.

The traditional M&O contracts generally include a provision requiring that costs must be reasonable. However, as a practical matter, costs incurred by DOE's management contractors have rarely, if ever, been disallowed because they were found to be unreasonable.

The key to effective use of the reasonableness standard in assessing the allowability of contractor costs is timely review by knowledgeable and experienced agency staff, taking into account sound business practices and specific programmatic requirements. Guidelines should be developed to aid Department staff in determining the reasonableness of contractor costs.

Management contractor costs should not be presumed to be reasonable merely because they are not specifically unallowable.



Action: Develop and implement a contractor indemnification scheme for response action contractors, consistent with the principles of section 119 of CERCLA.

Section 119 of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. 9601, authorizes the President to provide limited indemnification to "response action contractors" against any liability resulting from the contractor's negligence during the investigation and cleanup of a facility or site on the National Priorities List.

Section 119 of CERCLA protects response action contractors from liability under any federal law for injury or damage resulting from a release or threatened release of a hazardous substance, as long as the contractor is not guilty of negligence or intentional misconduct (i.e., protection against "strict liability" under federal law). Section 119 also authorizes the President to indemnify such contractors against any third-party liability resulting from their negligence. The indemnification specifically excludes liability resulting from gross negligence or intentional misconduct by the contractor. It also does not extend to liability under state law other than liability for negligence (for example, "strict liability" for "abnormally dangerous activities").

While some of the specific requirements and limitations of CERCLA section 119 and the guidelines may not be appropriate for the scope and extent of cleanup work at DOE sites and facilities, section 119 does offer a guide to the Department in fashioning the limits of its exposure to cleanup liabilities and to increase contractor accountability. The Department, therefore, should develop contract provisions and clauses to limit reimbursement of contractor-incurred, third-party liabilities resulting from environmentally related injury or damage. These provisions would be used in contracts for environmental cleanup work as appropriate.

Reducing Costs of Contractor Litigation



DOE spends over \$30 million annually to pay the fees of outside counsel retained by its contractors. These fees are incurred largely in defense of actions brought by third parties.⁴⁹

There is no written DOE guidance on the practices and procedures to be used by the Department's Operations Office Counsel to monitor ongoing litigation. As a result, the Chief Counsel in DOE's Field Offices have developed their own operating practices, which differ somewhat from office to office.

Over the last 10 years, the Department occasionally assumed direct responsibility for the defense of significant litigation filed against its management contractors. In recent years, contractors have managed most litigation with minimal involvement by the Department. Pursuant to the litigation and claims clause and the allowable-cost provisions contained in most M&O contracts. DOE Chief Counsel Offices have established various formal or informal methods for consultation with management contractors and approval regarding the conduct of litigation. On significant policy questions, Chief Counsel Offices coordinate with Headquarters litigation counsel.

These methods are not sufficient to control litigation expenses. The Department has examined the nature and scope of outside counsel expenditures and concluded that improvements are required in: (1) the com-

pensation arrangement employed by DOE contractors when retaining outside counsel; (2) cost-control mechanisms as litigation proceeds; and (3) litigation management strategies.



Action: Issue uniform guidance on the review and oversight of contractor litigation.

The issuance of written guidelines and procedures for Operations Office Chief Counsel review and oversight of contractor litigation will institutionalize cost-reduction and litigation management techniques. The written guidance will require that costreduction techniques be evaluated at the outset of the retention arrangement and, in turn, implemented by the contractor counsel. For example, careful review of retainer agreements will avoid overstaffing, layering of partners and associates, and unreasonable hourly rates and litigation support fees. Significantly, the guidance will encourage designation of lead counsel for each class action, to avoid duplication of effort when several law firms are hired by contractor counsel in multiple defendant cases. Specific advance approval by DOE will be required for the use of more than one law firm to perform any particular task in any given class action.

The guidance also will require that the Chief Counsel consider, in appropriate cases, the

use of innovative compensation arrangements, such as alternative fee arrangements, ⁵⁰ shared staffing, and teaming arrangements. Finally, contractors should be required to develop litigation management procedures that are consistent with the guidance issued by DOE.

Action: Institute training in litigation on management techniques.

Spiraling litigation costs have caused corporations across the country to scrutinize the litigation management practices of their legal departments and to develop novel costsaving approaches. The cost-reduction techniques mentioned in this report, as well as other more traditional approaches (for example, litigation profiles, discounting, and auditing), are the subject of commercial training courses and are discussed regularly by associations comprised of corporate counsel. DOE counsel could benefit greatly from such training.⁵¹



Action: Select one or two large pilot cases for immediate implementation of litigation cost-reduction techniques.

The General Counsel reviewed pending class action cases and identified one to serve as a pilot case for immediate implementation of appropriate cost-reduction techniques and for development of practical applications of these techniques. DOE counsel (Operations Office Chief Counsel and Headquarters counsel), in coordination with contractor inhouse and retained counsel, are in the process of conducting an analysis of the pilot case, including its costs, associated litigation strategy, and prospects for settle-

ment/trial, and are developing a strategy to minimize costs.

While work on the initial pilot case is underway, the Department is reviewing other pending class action cases to develop and implement a strategy for cost minimization.

Litigation management plans should address such issues as limiting the number and duration of depositions conducted by each side; limiting the number of lawyers who can attend the deposition; mock trials of cases to determine the likelihood of success on the merits and the adequacy of preparation by counsel; restrictions on the number of lawyers within a firm who can work on particular matters, to prevent cases from being used as training exercises for junior associates; the use of specialized contractors to serve as document reviewers and paralegals instead of the use of personnel at various law firms; and limitation on the number of drafts and the number of pages in briefs.



Action: Develop an explicit policy concerning the allowability of defense costs in "whistleblower" cases.

A Departmental initiative being undertaken in parallel with the Contract Reform Team's work is a Steering Committee established by the Secretary in November 1993 to consider issues associated with the Secretary's commitment to "zero tolerance" for reprisals against whistleblowers, and to review prior whistleblower complaints of employees who did not have available to them the protections afforded under the Department's Contractor Employee Protection Program⁵² or Department of Labor programs.

One of the issues being considered is the

extent of reimbursement of contractor costs of defending whistleblower actions. Such litigation costs and judgments would fall within the general cost principles currently applicable to M&O contracts, which generally permit the reimbursement of such costs, unless they are unreasonable, result from willful misconduct or lack of good faith on the part of the contractor's senior management, or otherwise are proscribed by law (for example, the Major Fraud Act of 1988).

The Whistleblower Steering Committee is concluding its consideration of the issues relating to the Secretary's commitment, and is examining the allowability of whistleblower defense costs to ensure that it is consistent with the Department's policy of "zero tolerance" for reprisal against whistleblowers. The Steering Committee expects to present recommendations to the Secretary in February 1994.

Specific Initiatives in Progress

The Department initiated efforts to change and improve its contracting practices before the Contract Reform Team began its work. The following programs and activities provide examples of these efforts. They reflect the Department's use of a variety of approaches to cooperate with the private sector in managing the Department's facilities more cost-effectively by improving the contracting process.



Freezing Salaries of M&O Contractors

On May 21, 1993, the Secretary of Energy announced that the Department had frozen the salaries of the employees of its management contractors for a period of one year. This initiative will save the government \$1.55 billion over a five-year period, including a savings of approximately \$220 million the first year. The savings in subsequent years result from the accumulated savings from not increasing salaries in Fiscal Year 1994. The freeze does not apply to promotion increases, and exceptions may be made for special circumstances.



Using Performance-Based Management Contracts at Rocky Flats

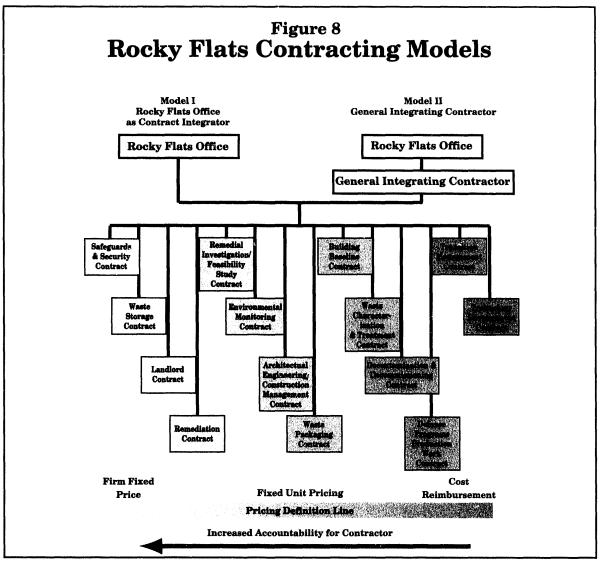
With the cessation of nuclear weapons production at Rocky Flats in January 1992, the Rocky Flats Plant began the transition from a production site to a site dominated by environmental restoration, cleanup, and waste management activities. In anticipation of the expiration of the current management contract at Rocky Flats on December 31, 1995, the Rocky Flats Operations Office has developed a new contracting strategy to reflect its new mission.

The objective of this strategy is to identify and develop contracting methods and practices that integrate industry and marketplace ingenuity into government procurement and operating practices at Rocky Flats. The approach will allow prospective contractors to define the work scope, operating parameters, incentives, and disincentives to accomplish the overall program goals. Key elements of the strategy include:

- Use of an appropriate mix of contractors and contract types, including fixed-price contracts.
- Identification of performance goals that focus on results.
- Use of performance-based criteria and measures.
- Use of contractor incentives.
- Increased competition among contractors for the variety of tasks at the site.
- Appropriate use of small and disadvantaged businesses.
- · Increased contractor accountability.
- Proposed use of government/private-sector partnership arrangements.

DOE is considering two model strategies for managing the contracts at Rocky Flats (Figure 8):

- Model I. The Rocky Flats federal staff will integrate all site contract actions.
 These contracts, as awarded by the Department, will range from administrative and landlord service functions, to the various cleanup work activities and technology development for the site.
- Model II. A general integrating contractor
 will support the Rocky Flats federal staff
 in their contract management activities by
 overseeing the same range of contracts
 covered in Model I. Just as in the first
 model strategy, this second strategy will
 require contracts to be awarded by the
 Department's staff. This second strategy
 would be necessary in instances where the



Department determines that specialized pro ject integration skills are available only from contractor sources. The ultimate objec tive would be to eventually have federal staff who are trained and experienced to assume these responsibilities.

The Department is soliciting suggestions from its stakeholders at Rocky Flats to develop site-specific strategic objectives and to break down the scope of work at the site to determine the appropriate mix of contractors, contract types, and contract provisions. In

other words, the new Rocky Flats contract strategy will be to choose from the wide variety of innovative, performance-based contracting tools described in this report to achieve the best contract results at the lowest cost to the government.

Reforming Competition at the Idaho National Engineering Laboratory

The activities of the Idaho National Engineering Laboratory (INEL) include

waste management, environmental remediation, reactor technology, spent fuel management and research, and advanced engineering in a broad array of technologies. In April 1993, the Department's Idaho Operations Office issued a Request for Proposals from industry, academia, joint ventures, and other team arrangements capable of innovative, entrepreneurial leadership. This Request for Proposals used a new approach in consolidating five incumbent M&O contracts into a single contract. Tailored to the specific programmatic purposes of the INEL, this solicitation was designed to result in a strong performancebased contract that is output- (product-) oriented, in contrast with the past input (budget) orientation.

In the Request for Proposals, DOE provided a detailed outline of the work to be done, a profile of current operations, and a list of the desired performance attributes in the management of the INEL. A central theme of the Request for Proposals was that, rather than being prescriptive in telling the offeror how to accomplish the work of INEL, the Department invited the offeror to be innovative and visionary in proposing approaches to accomplishing the work. DOE asked companies to address such matters as:

- The contractors' vision of what the INEL should be in 10 years.
- How they would manage costs, staffing, and organization.
- What their approach to enhancement of industrial competitiveness would be.
- How their efforts would enhance regional economic diversification.

- How they would build employee loyalty.
- How innovation and creativity would be instilled in employees.
- What their approach would be for compensation and innovative fee arrangements.

Consistent with the Department's contract reform efforts, the request also invited proposals on nontraditional contractor incentive arrangements that would result in cost savings in contract performance that would benefit both the Department and the contractor. In short, the new approach developed for the INEL requested contractors' input as to how DOE contractors are tasked, evaluated, and rewarded for their performance. The Department is in the process of evaluating the responses to the INEL Request for Proposals.



Financial Management Initiatives

The Department has undertaken a number of financial management initiatives aimed at improving contractor operations and contracting practices.

Improving Contractor Financial Management Systems

The Department's management contractors each operates separate and unique financial management systems. There is little commonality among contractors' systems, except for the ability to submit information within the parameters of the Department's reporting requirements. This results in data that may not be comparable between contractors.

Last year the Department chartered a Financial Management Systems Improvement Council. Membership on the council includes representatives from 10 contractors and 2 field sites, and 4 representatives from DOE's Office of Chief Financial Officer, including the Deputy Controller. The goals of the council are to improve contractor financial management system processes by (1) sharing successful approaches (best business practices) and benchmarking among contractors; (2) developing business requirements and common terminology for financial management systems; and (3) identifying systems that lend themselves to common processes and the pursuit of standardization where appropriate. Although these efforts are for the most part long term, initial results from benchmarking and the potential for system sharing show numerous opportunities for improving operational efficiency and future cost avoidance.

Including Financial Management Systems in the Five-Year Planning Process

For many years, federal agencies have been required to prepare and submit to the Office of Management and Budget five-year financial system plans. This requirement has been incorporated into the annual Information Resources Management Call for systems planning information.⁵³ Since the Department's management contractors spend large amounts of money on developing and enhancing financial management systems, the Department recently expanded the requirement to include them in the fiveyear planning process. Information collected through this mechanism will also be used by the Financial Management Systems Improvement Council to establish a baseline

and to track contractor financial management system efforts over the next several years.

Standardizing and Strengthening Financial Management Contract Clauses

The Department has taken steps to strengthen and standardize financial management clauses contained in its M&O contracts. Many of the M&O contracts did not contain contract clauses that other federal agencies commonly use to protect the government's interests (for example, cost accounting standards). To exacerbate this situation, significant deviations from DOE standard contract clauses existed within individual contracts.

The use of the standardized and strengthened contract clauses is a significant step toward improving the Department's financial management of its contractors. In 1994, the Department will be issuing these revised clauses through the *Federal Register* rulemaking process and will apply them to the new Performance-Based Management Contracts.

Requesting Audited Financial Statements of All Contractors

The Chief Financial Officers Act of 1990⁵⁴ requires federal agencies to prepare audited financial statements for commercial functions, including revolving and trust funds. While the Department has been in full compliance with the requirements of the Act, only a portion of DOE's management contractors have been covered by these audits.

Because a significant amount of the Department's funding flows through contractors, the Department is considering the costs of, and benefits to be derived from, extending the audited financial statement requirements to all contractors. A fully certified statement may entail additional costs that may exceed \$10 million. The Chief Financial Officer will provide a recommendation in April 1994.

Reviewing Unfunded Liabilities

The Department recently completed a review to determine whether liabilities, including contingent liabilities, of the Department and its management contractors were appropriately funded and recognized to prevent increasing fixed claims on revenues in future years. The review focused primarily on the following types of liabilities:

- Lease purchases and capital leases.
- Pensions.
- Post-retirement benefits other than pensions.
- Post-employment/termination benefits, such as severance and health insurance.
- Claims and judgments against management contractors.
- Workers' compensation under contractormanaged programs.
- Contract termination costs.

With the exception of the "post-retirement benefits other than pensions" category, the review indicated that the Department was properly using current budget authority to cover each of these management contractor liabilities.

The review also concluded that DOE faces a

multibillion-dollar liability for post-retirement benefits other than pensions. The Department has determined that it is not feasible to obtain the necessary budget authority to fully fund this liability. Therefore, it plans to continue to include, in annual budget requests, funds to cover that portion of the liability requiring payment during a particular fiscal year. The Office of Management and Budget has informally agreed with this approach. The Department is in the process of obtaining more accurate estimates that will provide the basis for recognizing the total post-retirement benefits other than pension liability in its financial statements.



Converting a Cost-Reimbursement Contract to a Fixed-Price Contract — Hanford Site

Providing a contract for the purchase of goods or services, while letting private firms undertake the capital cost, can insulate the government from cost overruns and the cost of future infrastructure improvements. The Hanford site⁵⁵ provides two examples of how this might be done. An analysis done by federal managers at Hanford showed that a private firm could construct and maintain the laundry facilities required at the site at a fraction of the price that the government could, principally through avoidance of DOE and contractor project management requirements. Under this new approach, the federal government pays for the outputs of the laundry—the laundry services themselves rather than paying for the capital costs and costs of operating the laundry directly. Precious capital funds could be reserved for priority environmental cleanup projects, rather than for this form of an indirect-cost project.

Another significant project at the Hanford

site, if undertaken, also might illustrate how even larger savings ould be obtained through the use of contracts in which the federal government pays for outputs, and private firms bear the risk of any cost overrun. Vitrification of the Hanford tank waste will require a large-capacity, commercial-scale facility to receive highly radioactive liquid waste, convert the liquid waste into solid glass, and provide interim storage of the glass waste before the shipment to a geological repository. A consortium of companies has presented a concept to design, construct, and operate a privately owned plant of sufficient capacity to process Hanford's liquid waste.

Under this concept, DOE would make no payments to the contractor until the vitrification capacity is actually available to the Department. Payments over the life of the contract would be based upon the plant capacity and output. The private owners of the facility would obtain their own financing.

The Department will be very receptive to the economic format of this type of proposal. However, for output contracts to work, the scoring rules applied by the Office of Management and Budget in the federal budget process require modification. Current scoring rules require realization of the entire contingent liability on a contract at the time of award. These rules encourage cost-reimbursement contracts that push the risk of cost overruns on the government. That type of incentive should be eliminated, and the Office of Management and Budget has indicated its willingness to consider the application of reasonable scoring rules so as not to discourage the signing of output-oriented contracts.

Reforming the Naval Petroleum and Oil Shale Reserves Program

The Naval Petroleum and Oil Shale Reserves program grew out of fears arising before and during World War I that the United States would run out of petroleum products to fuel the U.S. Navy fleet. Those fears have passed. After the Arab Oil Embargo, the United States began actively drilling on the Reserves and selling oil and gas commercially. The value of the Elk Hills field in California is demonstrated by the fact that it is the seventh largest producing field in the lower 48 states and produces more natural gas than any other field in California.

At Naval Petroleum Reserve No. 1 Elk Hills, which is located outside of Bakersfield, California, DOE is the operator. DOE operates Elk Hills under a traditional M&O contract, rather than an operating agreement, as is customary in the oil and gas industry. This arrangement has resulted in several inefficiencies.

For example, both the Department's program office and a panel of industry experts agree that the operation of the Elk Hills field with a traditional M&O contract, subject to the same rules and regulations that govern nuclear facilities, has resulted in substantially greater costs to the taxpayer than would be generated by a comparable site under private management. This report concludes that the M&O contractor's goal is to maximize the award fee, which is not necessarily consistent with maximizing the value of Elk Hills to the owners. For example, total (M&O contractor) costs increased 35 percent between 1986 and 1991, from \$125 to \$169 million per year. The contractor's annual profits (award fee) between this same period increased 44 percent, from \$3.1 to \$4.5 million. However, the total revenue at Elk Hills decreased 15 percent over this same period.⁵⁶

In addition, the lack of a federal capital budget discourages investment planning at Elk Hills. The two-year lag time between budget planning and funding creates further inefficiencies that would not be experienced by a private oil company.

Finally, the oil and gas from the Naval Petroleum and Oil Shale Reserves program are sold through a cumbersome federal process that conforms with restrictive statutory requirements to sell the petroleum competitively to the highest bidder. This practice imposes a significant cost on bidders and lowers the price the government would receive compared to prices that would be received from private sellers. A potential purchaser receives sales forms at least half an inch thick, rather than the few pages that would be used by a private seller in its contract to sell oil.

To reform the Naval Petroleum and Oil Shale Reserves program at Elk Hills, consistent with the thrust of this report and the National Performance Review, the Department will:

- Consider using an operating contract modeled after traditional commercial standards. A commercial operating agreement typically designates a substantial equity owner in the oil and gas field to manage and operate a field. This approach serves to reduce the costs of operations and maximize the incentives for increasing net revenues.
- Convene a meeting of various

Departmental elements in February 1994 to discuss on an order-by-order basis all Headquarters orders, rules, directives, and regulations that have been specifically identified by the program as adding to costs without significantly adding value. In each case, the management group will consider least-costly means to accomplish the same objectives.

The purpose of all these reforms would be to replace an M&O contract with a performance-based contract, focusing on performance criteria similar to those used by a board of directors of a sophisticated private oil company.⁵⁷ The Department expects this action to increase revenues and cut program costs by 1995.



Making the Environmental Management Program a Pilot Program

Some of the challenges being addressed by DOE's Environmental Restoration and Waste Management program are:

- Management and cleanup of waste created as a result of research, development, and production of nuclear weapons and nuclear energy at 110 DOE sites across 32 states.
- Continued growth of work scope as the program undertakes the decontamination and dismantlement of additional surplus defense-related facilities.
- Management of the remediation of 400 buildings in the nuclear weapons complex, with another 1,150 buildings to be transferred into Environmental Management from other DOE programs. Another 1,450 potentially contaminated buildings exist in the complex.

DOE recently proposed using the Environmental Management program as a pilot under the Government Performance and Results Act, which requires strategic planning based on measurable performance indicators. DOE requested that the Office of Management and Budget allow the Environmental Restoration and Waste Management program to increase its staff by 1,600 positions (400 in Fiscal Year 1994, 800 in Fiscal Year 1995, and 400 in Fiscal Year 1996). The savings are estimated to exceed \$500 million over three years as a result of substantially increased federal management of DOE contractors. These new positions will significantly increase the efficiency and effectiveness of its cleanup program, enable DOE to significantly reduce the most serious public health risks, and accelerate commercialization of promising environmental cleanup technologies. The program also includes specific performance measures, which will better enable the program managers to improve the efficiency of the program and permit external reviewers to track the program's success.

The Office of Management and Budget has approved 400 additional full-time positions in Fiscal Year 1994 and 800 additional positions in Fiscal Year 1995.

Reducing and Streamlining Internal Regulations and Directives

The Department has initiated a new management system to improve the processes for developing, coordinating, and implementing DOE internal regulations and directives. The system will result in streamlined and value-

added internal regulations, including local requirements issued by DOE Headquarters and Field Offices.⁵⁸

The Department has developed a two-step strategy to implement the new system:

- A Department-wide steering group has responsibility for coordinating the task and providing consistency in approach.
 The focus will be on identifying and eliminating nonessential requirements, clearly separating requirements from guidance, and consolidating requirements.
- Departmental elements that issue internal regulations will be responsible for documenting internal approaches, identifying near- and mid-term targets for eliminating, streamlining, consolidating, and conducting a detailed review of their internal regulations by July 1, 1994. Consolidations and revisions are to be completed by September 1996.

Implementation of this plan will allow the Department to significantly reduce the volume and burden of its internal regulations. The plan also should reduce the costs incurred by contractors to comply with contractual requirements imposed by the directives.

V. Next Steps

he steps necessary to reinvent DOE's contracting process effectively are numerous, and will require ongoing efforts. Some recommendations in this report do not fit the many unique circumstances of all of the activities that comprise the Department's mission.⁵⁹ Implementing the plan will need to take into account the diversity of the Department's activities, since "one size" does not "fit all." The major initiatives of this plan will not be implemented until after the Department digests the feedback it obtains from its various stakeholders, as well as from Departmental personnel, during the 30day comment period.

Implementing Contract Reform

reform initiative is changing the way the Department has traditionally approached its contracting for the management and operation of its laboratories and production facilities. The move away from specifying and measuring inputs to stipulating performance expectations and measuring and rewarding outputs is the essential component of change. As indicated in this report, this effort will be realized primarily through the use of performance criteria and measures in the Department's Performance-Based Management Contracts.

Effecting change of this magnitude is an enormous challenge. For example, in reviewing DOE's current inventory of 52 M&O contracts:

- Sixteen contracts expire by December 31, 1994. For these contracts, the extend/compete decision process is already underway.
- One contract expires on March 31, 1995.
 The extend/compete decision process must begin in the first quarter of calendar year 1994.
- An additional seven contracts will expire during the fourth quarter of calendar year 1995. The extend/compete decision process for them must begin during the second quarter of calendar year 1994.

Even under existing practices, the extension or recompetition of these 24 contracts represents a significant undertaking. Under the contract reform initiative, the Department's current resources in all areas of accounting, procurement, counsel, and program management will be subjected to significantly greater demands. For example, under the new contracting strategy, the number of competitive contract awards is expected to increase, thereby increasing the resources needed to conduct acquisitions.⁶⁰ Although it is impossible to calculate the additional staff, time, and financial commitments needed to fully implement the reforms outlined in this report, the need for more and better trained people in all areas of contract award and administration is clearly stated throughout this report.

The actions highlighted throughout this report and listed in the Introduction will significantly reform DOE's contracting practices and management systems. The individuals and managers of the programs specified in the list of actions will bear the primary responsibility for implementing the actions. In addition, the Department will establish a committee comprised of a crosscutting group of senior Department managers, including the Deputy Secretary and the Under Secretary. This executive committee will:

- Evaluate the progress of individual managers in accomplishing the actions by the specified deadlines.
- Ensure that these individuals have the resources and Department-wide cooperation necessary to accomplish the actions.

- Initiate a review of each existing M&O contract, and develop a baseline to determine which contracts will benefit most from the reforms. In cases where it would not be in the Department's best interest to attempt immediately to adopt the reforms in an existing contract or to compete it, the contracts should be extended for only one or two years.
- Designate specific sites for pilot projects to permit a managed implementation of Performance-Based Management Contracts. Through these projects, the Department can apply "real-world" experience to test the applicability and cost-effectiveness of its new contracting approach, including, for example, the validity of specific performance criteria and measures and incentives.
- Require additional actions based on recommendations resulting from the studies performed by Departmental managers, in accordance with the actions required in this report.
- Identify new issues for review.



Changing the Mix of Skills at Various Sites

An important corollary to DOE's contract reform initiatives is the need for the Department to examine the mix of personnel skills at its weapons production facilities. In the past, DOE explicitly required new M&O contractors to retain the previous contractor's work force. This requirement substantially limited a new management contractor's ability to instill its own corporate culture. Moreover, many of the former weapons production facilities now have as a principal mission waste handling and envi-

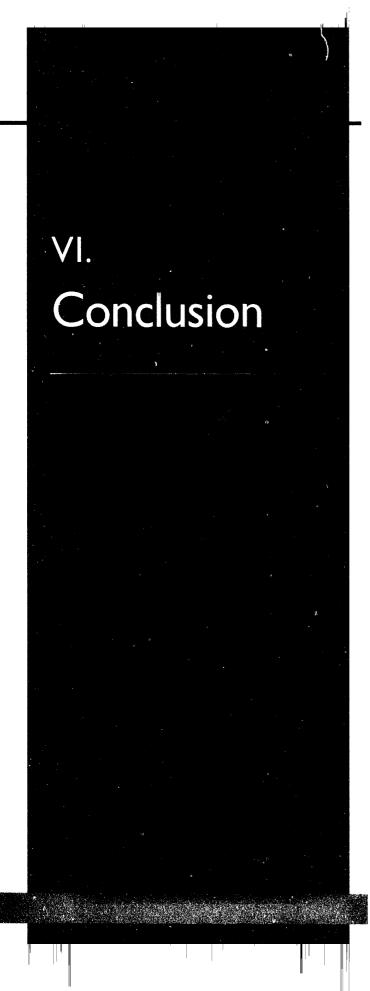
ronmental restoration. The workforce retention limits the new contractors' ability to change the mix of skills needed to accomplish this important new mission.

Of course, often the personnel with historical experience at a production facility can have a significant advantage over new workers in the cleanup process. It may be cheaper to retrain some of those workers than to have to train new workers in the risks and handling of waste at the site. Moreover, Section 3161 of the National Defense Authorization Act for Fiscal Year 1993 requires the Secretary of Energy to develop a plan for restructuring the workforce for a defense nuclear facility in cooperation with stakeholders, whenever there is a determination that a change in the workforce is necessary. Section 3161 provides objectives to guide the plan's preparation that are aimed at reasonable actions to mitigate the effects of workforce restructuring at defense nuclear facilities.

To balance these concerns, the Department should not explicitly require the existing workforce to be retained by a new contractor. Each new contract should inform offerors that workforce retention must be consistent with an overall plan specified by the Department. Ordinarily, the plan would include a preference for employees at the site with some seniority over new employees, where there are no significant differences between skills for the needed position. DOE should also solicit the offerors' views on how their human resources policies will ensure that they perform the work most efficiently at a site, in a cost-effective manner consistent with an overall objective of using the skills of experienced people at the site who have invested their lives in the community.

Labor/management relations need not be an impediment to seeking greater competition in the awarding of contracts. To maximize the confidence of the workers that contract competition will not be misused simply as a bargaining tool, new Performance-Based Management Contracts awarded for functions previously performed by a manage-

ment contractor using unionized employees will require the new contractor to "recognize" the union certified to represent the employees performing the same work under the new contract, whenever the new contractor would be a "successor" under applicable law.61



y undertaking the actions set forth in this report, the Department of Energy will create a system of contracting that works better and costs less. These actions will:

- Minimize the potential for waste, fraud, and abuse inherent in the Department's current contracting system.
- Give the Department's contractors the benefit of clearly stated and objective performance criteria and measures, so that they will know what the Department's expectations are and will be better able to decide how to satisfy those expectations.
- Give DOE managers the information and the tools they need to manage the Department's programs effectively, particularly for managing and overseeing DOE contractors.
- Create meaningful incentives for contractors to perform better at less cost.
- Attract new competitors for DOE contracts, enlarging the pool of talented and efficient service providers to help DOE accomplish its important missions.
- Create a clear distinction between the roles of federal workers and contractors, so that the implementation of the Department's missions is firmly under federal control.

The actions that the Contract Reform Team proposes may draw criticism from many groups. The Department hopes to engage its critics and its supporters in a meaningful dialogue that, in some cases, will reinforce DOE's commitment to the actions stated in this report and, in other cases, will convince DOE that a different action is required. In the end, the Department's reformed contracting system will in fact work better and cost less, and DOE will have made a significant contribution to the efforts of President Clinton and Vice President Gore toward reinventing our government.

Endnotes

- 1. Appendix A describes the Contract Reform Team's structure and membership.
- 2. This report reflects principles articulated in Al Gore, From Red Tape to Results—Creating a Government That Works Better & Costs Less, Report of the National Performance Review, Washington, D.C., Sept. 7, 1993 (hereinafter referred to as the National Performance Review).
- 3. Other contracts include contracts for research and development services, architectural and engineering services, hardware and equipment, and utilities.
- 4. Four contractors—the University of California, Martin Marietta, Westinghouse, and EG&G—employ nearly 80,000 workers at several DOE sites encompassing 2.7 million acres and 8,300 buildings with dozens of different missions.
- 5. Appendix B describes in detail the history of the development of these contracting practices.
- 6. J. Hinkley, W. Krebs, Jr., R. Robne Jammoro, and J. Loofbourow, Report Advisory Board on Relationships of the Advisory Commission With Its Contractors (First Rev. June 30, 1947).
- 7. Reimbursement of a contractor's costs under this and the other cost-type contracts described in this report is subject to Department and government-wide regulations and policies concerning reasonableness, allowability, and allocability. See Department of Energy Acquisition Regulation Subpart 970.31, 48 C.F.R. Subpart 970.31 (1992) (rules applicable to M&O contracts). See also Federal Acquisition Regulation Parts 30 and 31, 48 C.F.R. Parts 30 and 31 (1992).
- 8. For example, in a recent competition for the contract to manage DOE's Savannah River site, only two companies bid. Moreover, although the Department has generated considerable interest in the Idaho contract competition, relatively few of the fastest-growing, most entrepreneurial,

- high-technology companies and nonprofit institutions were willing to bid for that contract.
- 9. In addition to the fundamental problems addressed by this report, individuals who have carefully scrutinized the Department have raised numerous other specific criticisms of DOE contracting practices. Rather than simply reexamining much of this analysis, the Contract Reform Team accepted a number of these criticisms and has addressed them in this report. Many of these criticisms are summarized in Appendix C.
- 10. See National Performance Review, pp. 45-47.
- 11. Appendix D summarizes the stakeholder process.
- 12. See Federal Acquisition Regulation Subpart 16.5, 48 C.F.R. Subpart 16.5 (1992).
- 13. A recent study of the Department's Environmental Restoration program's project management found that so-called "fixed-price" contracts often are not actually fixed-price at all. Independent Project Analysis, Inc., The Department of Energy Office of Environmental Restoration and Waste Management Project Performance Study, pp. 67-70 (November 30, 1993). Appendix E includes a summary of this study.
- 14. See also U.S. Department of Energy, Office of Environmental Restoration and Waste Management, Benchmarking for Cost Improvement (September 1993).
- 15. As described in Federal Acquisition Regulation 15.903(d), 48 C.F.R. §15.903(d)(1992), certain statutory limitations are applicable to the fees for particular types of contracts, such as the performance of architectengineering services and experimental, developmental, or research work under cost-plus-fixed-fee contracts. The Federal Acquisition Regulation specifies that deviations from the fee limitations may be authorized for cost-plus-incentive-fee and cost-plus-award-fee contracts.

- 16. These types of incentives are described in Federal Acquisition Regulation 16.402, 48 C.F.R. §16.402 (1992).
- 17. Federal Acquisition Regulation 16.402-4 recognizes this possibility, and requires that all multiple-incentive contracts contain a cost incentive or constraint that operates to preclude rewarding a contractor for superior technical performance or delivery when the costs of those results outweigh the value to the government.
- 18. As specified in DOE Order 5000.4A (April 4, 1992), it is the policy of the Department to allow each multiprogram laboratory to carry out a limited amount of basic and applied research and development that focuses on early exploration and exploitation of creative and innovative concepts selected at the discretion of the laboratory director.
- 19. This test should be conducted in accordance with the extend/compete policy, as discussed under Increasing Competition to Improve Performance in section II of this report.
- 20. This number includes the contract for the Superconducting Super Collider Project, which is in the process of being terminated as of the date of this report.
- 21. DEAR 970.1509-2, 49 C.F.R. §970.1509-3(1992), sets out a policy against the payment of management fees to educational institutions, but permits such payments if justified and approved. A significant exception is the University of California.
- 22. See Modifying and Improving Cost-Reimbursement Policies in section III of this report.
- 23. See Part 48 of the Federal Acquisition Regulation, "Value Engineering." 48 C.F.R. Part 48 (1992).
- 24. DOE's policies on cost sharing for contracts other than M&O contracts are contained in DEAR Subpart 917.70, "Cost Participation." 48 C.F.R. Subpart 917.70 (1992). These policies should be considered in developing policies applicable to management contracts.
- 25. A clause implemented recently in the University of California's contracts to manage

- and operate the Department's Los Alamos, Berkeley, and Livermore laboratories requires contractors to:
- Ensure that their performance protects the environment and the health and safety of workers and the public.
- Ensure that their performance is in compliance with all applicable environment, safety, and health requirements.
- Submit an environment, safety, and health program management and implementation plan within 30 days of award.
- Require subcontractors to comply with the contractor's environment, safety, and health requirements.

The same clause permits the Department to issue a "stop-work order" and to compel the contractor to take corrective action on notice of noncompliance.

- 26. For example, a team consisting of a Department program officer and operations officer and a management contractor may conceive a particular research project. In deciding how to implement the project, however, they would explore the full range of options among the existing DOE facilities, facilities of other government agencies, and various private-sector companies to determine who might best perform the project or research. The decision might entail noneconomic considerations, such as the need to maintain particular competencies necessary to pursue national strategic goals, but it should not presume that a management contractor whose activities originated the project or area of research would necessarily perform the activity itself.
- 27. The Federal Acquisition Regulation, which was published in 1984 and was designed to provide government-wide procurement regulations, sanctions the Department's use of M&O contracts (FAR Subpart 17.6), 48 C.F.R. Subpart 17.6 (1992). Because the M&O concept varies from traditional governmental standards, the FAR establishes procedures for senior-level designation of M&O contracts. FAR also recognizes the extend/compete process, which permits an unlimited number of extensions, but subjects the decision to a disciplined review prior to taking such action. See also DEAR 917.605, 48 C.F.R. 917.605 (1992).

- 28. For example, Allied-Signal, Inc., has operated DOE's Kansas City Plant since 1948, and Iowa State University has operated the Ames Laboratory since 1943.
- 29. DEAR 970.0001, 48 C.F.R. 970.0001 (1992). DOE Order 4210.5A, "Operating and On-site Service Contract Extend or Compete Decisions," 6-23-92.
- 30. For example, see the Actions contained in the following subsections of this report: Increasing the Use of Fixed-Price Contracts, Making Cost-Effective "Make-or-Buy" Decisions, Increasing Competition to Improve Performance, and Reducing the Use of Contracts for Support Services.
- 31. The so-called Section 800 Panel received its charter from Section 800 of the National Defense Authorization Act of 1992, Pub. L. No. 101-510, sec. 800, 104 Stat. 1587. This advisory panel of government and private-sector experts was charged to review all laws affecting DOD procurement, "with a view toward streamlining the defense acquisition process." The panel, which transmitted its report to Congress in January 1993, focused on three areas: streamlining, commercial items, and simplified acquisition. In addition to numerous recommendations regarding regulatory authorities, nearly 300 of the 600 laws reviewed by the panel were recommended for repeal or amendment. Legislative initiatives, some of which would have had government-wide effect, were introduced, but not enacted, last session. Legislative action is expected to resume this year.
- 32. For a discussion of government-wide service contracting practices, see Office of Management and Budget, Summary Report of Agencies' Service Contracting Practices (January 1994).
- 33. Within Headquarters alone, an estimated 1,900 contractor staff work with approximately 6,300 federal employees. Program officials often rely on these support service contractors for many daily functions and perform limited oversight. This close working relationship suggests that new federal employees could replace a number of contractors.
- 34. For a review and assessment of DOE's finan-

- cial management structure and procedures, see United States General Accounting Office Report, Financial Management: Energy's Material Management Weaknesses Require Corrective Action (AIMD-93-29) (Sept. 1993).
- 35. A study conducted in Fiscal Year 1991 identified 83 Headquarters-led oversight reviews and 1,547 Field-conducted oversight reviews in a 12-month period. The Field reviews involved 87,758 staff days of reviewer effort. The study did not address the number of staff days expended by the "reviewed" organizations as they prepared for the on-site visits and responded to reports that were written. That same study found that the Nevada Operations Office alone was the subject of 28 separate reviews that encompassed 1,804 staff days of effort.
- 36. This strategy is similar to the Cooperative Risk Assessment Guide program used by the Defense Contract Audit Agency for its auditing of defense contractors.
- 37. This report does not address general cost allocation principles. A recent oral presentation by the General Accounting Office alerted the Department to perceived weaknesses in the Department's cost allocation procedures. These weaknesses would not result in a loss of some dollar amount to the government, but they could result in failure to allocate resources in accordance with statutory or Secretarial priorities. The Department's Associate Deputy Secretary for Field Management and the Chief Financial Officer are jointly being asked to make a recommendation separate from this report on this issue.
- 38. DOE Order 4700.1 (Project Management System), DOE Order 2200.13 (Oversight of Integrated Contractor Financial Management), DOE series of Orders 5500 (Emergency Management System), and 5480 (Environment, Safety, and Health Program for Department of Energy Operations).
- 39. Additionally, DOE's motor vehicle fleet consisted of 20,731 vehicles, 13,776 of which were DOE-owned and 6,955 were leased from the General Services Administration.
- 40. For example, a recent audit of personal property at one national laboratory disclosed that, out

of a total inventory of approximately \$1 billion:

- \$100 million worth of personal property may not be accounted for,
- \$207 million may not be correctly recorded in the data base, and
- substantial amounts of personal property on loan to employees and other entities were at risk of unauthorized use.

This audit occurred after \$11 million in property had already been determined to be lost or stolen and removed from the contractors' inventory records. See DOE Inspector General Report No. I-O-33-8, "Audit of Personal Property Management at Los Alamos National Laboratory" (December 7, 1993).

- 41. A series of DOE Orders governs facilities and real property managemen: DOE Order 4300.1C, Real Property Management, and DOE Order 4330.4A, Maintenance Management Program.
- 42. The General Services Administration is reorganizing its real estate property management functions based on benchmarking with successful private-sector organizations. A good model for this kind of benchmarking study is the Project Management Study recently undertaken by the Department's Environmental Restoration and Waste Management program.
- 43. In addition to providing for cost reimbursement, M&O contracts have provided indemnification for certain losses of the contractor. True indemnification is an expressed contractual obligation to make good loss or damage a contractor incurs as a result of performance of work under a contract with the government. Such provisions are based on specific statutory authority and are not subject to funding limitations. Except pursuant to statute, such as P.L. 85-804 or the Price Anderson Amendments Act, the Department has not indemnified its M&O contractors. Instead, the Department has used costreimbursement contract clauses to compensate the contractors for the actual costs incurred to perform the contracts. Cost reimbursement is subject to the availability of appropriated funds and is limited by specific allowability requirements.

- 44. The contractors were reimbursed for their costs to implement the rule.
- 45. See Office of the Inspector General, Report on Audit of Implementation of the Accountability Rule (January 21, 1994).
- 46. See Incentives for Contractor Performance, under section II of this report.
- 47. See DEAR Subpart 970.31, Contract Cost Principles and Procedures 48 C.F.R. Subpart 970.31 (1992).
- 48. This refers to civil fines and penalties. Criminal fines and penalties will continue to be disallowed.
- 49. Three Operations Offices—Albuquerque, Oak Ridge, and Richland—each reported contractor outside counsel expenditures in excess of \$7 million for Fiscal Year 1992. Final Fiscal Year 1993 costs are likely to be in the same range. Between 50 and 75 percent of the contractor legal costs reported by these three offices is attributable to "toxic tort" class action suits filed against current and former DOE contractors employed at these sites.
- 50. For example, lower hourly rates with performance bonuses if counsel prevails.
- 51. In addition, a roundtable discussion between DOE and contractor counsel at the semiannual DOE Counsel conferences will provide an opportunity to share information and "lessons learned." Such a roundtable discussion occurred at the fall 1993 conference, and ongoing dialogue on this subject will continue.
- 52. See 10. C.F.R. Part 708 for a description of this program.
- 53. The Information Resources Management Call is the Department's annual request for information pertaining to Organizational Information Resource Management (IRM) Plans. This information supports and documents each organization's (and collectively the Department's) IRM strategy, including hardware, software, and connectivity objectives.
- 54. 1 U.S.C. §§501, et seq.

- 55. The Hanford site consists of over 350,000 acres located in the southwest area of Washington State. The principal functions now being performed at the site involve research and development and waste management to accomplish DOE's environmental restoration program.
- 56. Evaluation of Operations at Naval Petroleum Reserve No. 1: Report to Congress by an Independent Industry Panel, p. IV-6 (October 1993).
- 57. Reforms also need to be made in DOE Headquarters directives to allow the program managers within the Department the flexibility to accomplish these objectives.
- 58. Executive Order 12861, "Elimination of One-Half of Executive Branch Internal Regulations," dated September 11, 1993, provided specific direction to federal agencies to accomplish a 50 percent reduction in internal regulations. The Office of Management and Budget provided additional guidance on this order in October 1993, requesting that agency implementation plans be completed by December 1, with reductions to be achieved by September 1996. The DOE strategy for reducing and streamlining its

- internal regulations and directives is broader and more inclusive than that required by the Executive Order and the Office of Management and Budget.
- 59. For example, the Naval Nuclear Propulsion Program is subject to certain oversight and control requirements, as set forth in Executive Order 12344 (statutorily prescribed by Public Law 98-525, 42 U.S.C. Section 7158).
- 60. Using the recent Sandia and Idaho National Engineering Laboratory Source Evaluation Board experiences as examples, the competitive contracting process requires a full-time commitment of seven to nine individuals. In addition, numerous personnel from within and outside of the Department support the Source Evaluation Board as technical and financial advisors, auditors, and other subject-matter experts. As these examples show, a decision to compete a predominate number of DOE's expiring contracts will require a substantial personnel commitment.
- 61. The terms "recognized" and "successor" are used in the National Labor Relations Act, as amended.